OPERATION OF ESTATE DUTY AND GIFT TAX IN INDIA - A REVIEW

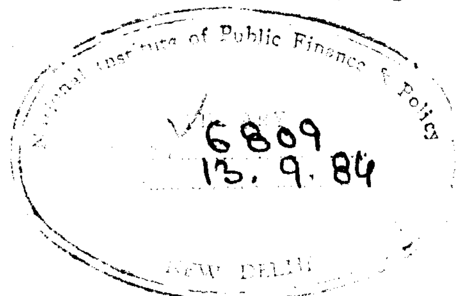
Prepared by

Amaresh Bagchi

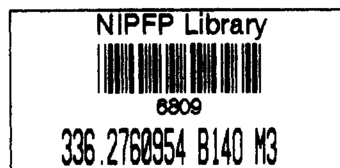
and

S P Chaudhury

March 1983



NATIONAL INSTITUTE OF PUBLIC FINANCE AND POLICY
NEW DELHI


NIPFP Library
6809
336.2760954 B140 M3

ACKNOWLEDGEMENTS

The study on the Operation of Estate Duty and Gift Tax in India presented below was undertaken by the Institute at the instance of EARC. The study commenced in June 1982. Part I of the report was submitted in January 1983 and Part II in March 1983.

The Central Board of Direct Taxes took keen interest in the study and extended its good offices in facilitating it. It would not have been possible for the Institute to carry out the study and undertake the sample survey of estate duty cases required for it without the help and support of the Income Tax Department. The Institute would also like to place on record its appreciation of the help and cooperation received from the officers and their staff working in the estate duty circles at Ahmedabad, Bombay, Calcutta, Delhi and Kanpur. Special thanks are due to Shri V.B. Deval, Assistant Controller of Estate Duty, Bombay for valuable assistance.

Kumari Sushila Panjwani, Mr. K.R. Subramanian Iyer and Mr. R.S. Tyagi typed out the drafts and the final report with great patience and care.

List of Tables in the Text

		Page No.
1.	Revenue from taxes on capital and capital transfer, and their proportion in Gross Tax Revenue of the Centre, and the combined Tax Revenue of the Centre and States (1960-61 to 1981-82).	4
2.	Revenue Receipts from Taxes on capital and capital Transfer (other than Tax on capital Gain) and total Tax Revenue of the Centre and States (1960-61 to 1980-81) at constant prices.	8
3.	Buoyancy of Revenue from ED, GT, WT, Stamps and Registration, Gross Total Tax Revenue of Centre and combined Tax Revenue of the Centre and States, with respect to GDP (1960-80).	10
4.	Proportion of Revenue from Taxes on Property, Inheritance and Gifts in the Total Revenue, Total Tax Revenue and Direct Taxes of the Government in Selected Countries in the Seventies.	13
5.	Rate Structure of Estate Duty.	16
6.	Nominal Incidence of Estate Duty and Gift Tax (As Per Cent of P.V.) at Selected Levels of Estates/Gifts in 1960 and 1982.	17
7.	Distribution of Estates, Gifts and Net Wealth Assessed for ED/WT/GT (1964-67 and 1977-80).	19
8.	Concentration Ratios of Estates and Wealth Assessed under the ED and WT Acts.	21
9.	Average Incidence of Estate Duty for Different Categories of Estates (1959-60 to 1979-80).	23
10.	Number of Assessments and Demand Raised for ED (1970-71 to 1981-82).	26

CONTENTS

PART I

		Page No.
1.	Introduction and Trends in Revenue from Estate Duty	1
2.	Impact of the Levy	15
3.	Factors Underlying Low Yield and Incidence of Estate Duty	25
4.	Cost of Collection and Burden of Compliance	59

PART II

5.	The case for Taxation of Capital and Capital Transfers	74
6.	Structure of Transfer Taxes	92
7.	Possible Lines of Reform	110
8.	Appendices:	
	Appendix 1 : A Note on Section 10 of the Estate Duty Act 1953	154
	Appendix 2 : Discretionary Trust as a Medium for Avoidance of Estate Duty	163
	Appendix 3 : Extracts for Full Report of the Taxation Review Committee, Government of Australia (1973)	169
9.	Summary of Conclusions and Recommendations	174
10.	Citations	189
11.	References	191

Page No.

		Page No.
11.	Proportion of Assessments under ED, and GT to Assessments under WT (1965-67 and 1978-80).	29
12.	Proportion of ED Assessments and Assessments made for ED and GT to Assessments under WT.	30
13.	Proportion of ED Cases where Deceased Assessed to Income Tax and Wealth Tax.	32
14.	Average Assessed Value of Estates (1960-61 to 1979-80).	35
15.	Composition of Estates Assessed to Estate Duty (1960-61 to 1979-80).	37
16.	Composition of Movable Property Assessed to Estate Duty.	38
17.	Distribution of Differences Between Assessed Values of P.V. and Value of Per Return - According to Range of Variation.	40
18.	Reduction in ED Assessments Allowed by Appellate Authorities.	42
19.	Rebates and Allowances in ED (1970-71 to 1979-80).	45
20.	Distribution of ED Cases According to Religion of Deceased.	47
21.	Distribution of ED Cases According to School of Hindu Law.	48
22.	Proportion of Joint Family and Partly Joint Family in ED Assessments (1959-60 to 1979-80).	49
23.	Assessments and Demand Raised in Gift Tax (1970-71 to 1981-82).	51
24.	Deduction as a proportion of Gross Value of Estates in ED and of Gross Value of Gifts Assessed under GT (1965-66 to 1979-80).	52
25.	Analysis of Pending ED Cases (Age-wise) as on 31.3.1981.	57

Page No.

26.	Source of Death Report.	58
27.	Revenue and Cost of Collection of Income Tax and Estate Duty (1972-73 to 1981-82).	60
28.	Mode of Representation of Cases in ED.	61
29.	Time-Lag Between Filing of Return and Issue of Clearance Certificate (Exemption Cases).	63
30.	Time-Lag Between Filing of Return and Issues of Clearance Certificate (Dutiable Cases).	65
31.	Causes of Delay.	66
32.	Comparative Incidence of ED and GT.	70
33.	Influence of Basic Aims on Answers to Selected Technical Question in Death and Gift Taxation.	105
34.	Composition of Incidence of ED for PV under Dayabhaga and Mitakshara Schools.	124
35.	Proportion of Arrears to Current Demand and of Total Collections to Total Demand in Direct Taxes.	139
36.	Distribution of Provisional Assessment.	141
37.	Proportion of Cases where Provisional Demand Paid.	141
38.	Distribution of Cases Pending for More than 5 Years as on 31.3.1982-According to Length of Delay.	142

CHAPTER I

INTRODUCTION AND TRENDS IN REVENUE FROM ESTATE DUTY

Introduction

The estate duty was introduced in India with effect from October 15, 1953 following the recommendations of several expert bodies and panels dating back from the Taxation Enquiry Committee of 1924-25. The objective underlying the levy was stated to be primarily to reduce the concentration of wealth and help to achieve the goal of an egalitarian society. It was also expected to provide an additional source of revenue for the States to finance their development as the proceeds of the tax are required under the Constitution (Article 269) to be distributed among the States.

Although it has been in operation for nearly three decades now, the estate duty in India, it is generally felt, has not fulfilled any of the underlying aims. Its contribution to revenue has been almost negligible, forming less than 0.5 per cent of the gross tax revenue of the Centre. In absolute terms, its yield is currently of the order of only Rs 16-17 crore per annum. Many would be inclined to think that a tax yielding so little in revenue can hardly make any difference to the concentration of wealth and the high marginal rates prescribed in the law are of no consequence as few among the rich leave any estate to be taxed at those rates. Compliance with the requirements of the legislation implementing the tax, on the other hand, is widely regarded as a source of acute harassment and distress to heirs of small and medium-sized

estates. The present study seeks to review the working of the estate duty in India, especially the reasons for its low yield and examine in that light whether there is any case for its continuance, and if so, in what form. The findings of the study are presented below. The report of this study is in two parts. Part I contains a review of the operation of the estate duty in terms of revenue yield, its impact on inequalities and the factors undermining its efficacy. An attempt is also made to investigate whether the administration of the duty has caused any avoidable harassment to heirs of small estates. In part II we examine the various issues which arise for consideration in the taxation of capital and capital transfers and explore the lines along which the existing system of estate taxation might be reformed.

The sources of data relied upon for this study mainly are: (i) the _All India Estate Duty, Gift Tax and Wealth Tax Statistics_ published by the Directorate of Inspection (Research, Statistics and Public Relations) of the Income Tax Department and (ii) a survey undertaken by this Institute for the project, organised through the good offices of the Central Board of Direct Taxes. The _All India Estate Duty, Gift Tax and Wealth Tax Statistics_ provided the basic data regarding the number of assessments and value of estates assessed from year to year, their distribution, demand raised, and rebates, reliefs and allowances. Information regarding revenue was obtained from the budget documents of the Central Government. Disaggregated data on assessments, demand and collections were made available by the Directorate of Inspection (IT) and (RS&P). As some of the information required for the study was not available from any other source, a sample survey of estate duty assessments was carried out at 5 major centres of estate duty administration in the country, namely, Ahmedabad, Bombay, Calcutta, Delhi and Kanpur. Taken together, these centres account for roughly one-third

of the total number of estate duty cases handled all over India. The sample consisted roughly of 10 per cent of the exemption cases, 5 per cent of dutiable cases with estates ranging between Rs 50,000 and Rs 5 lakh and a higher proportion of estates of more than Rs 5 lakh assessed at these centres during the three years 1979-80, 1980-81 and 1981-82. The selection of the samples was made as far as possible on a random basis.

Trends in revenue from Estate Duty

Figures of revenue from the estate duty (ED) from 1960-61 to 1981-82 are set out in Table 1. As the gift tax (GT) levied since 1958 complements the ED, figures of revenue from the GT too are given in Table 1. The table also shows the yield of the wealth tax (WT) and of Stamps and Registration which together with the ED and the GT (and the tax on capital gains) constitute the principal taxes on capital and transfers of capital levied by the Centre and the States in India.[1,2]

Column 10 of the table indicates the proportion of collections from ED and GT to the gross tax revenue of the Centre and Column 11, that of the revenue from ED,

---

1/ Comparable figures of tax realised on capital gains are not available and hence are not presented in the table. From available income tax statistics it appears that the tax demand on capital gains was Rs 5 crore, Rs 2.2 crore and Rs 1.6 crore in 1977-78, 1978-79 and 1979-80, respectively.

2/ Another reason for including the revenue from Stamps and Registration is that the fees paid for probate and succession certificates are set off against the ED payable in respect of the same assets.

TABLE 1

Revenue from Taxes on Capital and Capital Transfer, and their Proportion in Gross Tax Revenue of the Centre, and the Combined Tax Revenue of the Centre and the States

(1960-61 to 1981-82)

(Rs crore)

Year	Estate duty	Gift tax	Total of ED and GT	Wealth tax	Stamps and registration	Total of columns 4,5 & 6	Total gross tax revenue of the Centre	Combined tax revenue of the Centre and the States	Column 4 as percent of col. 8	Col.7 as per cent of col.9
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1960-61	3.09	0.89	3.98	8.15	47.01	59.14	908.9	1350.4	0.44	4.38
1961-62	4.21	1.01	5.22	8.25	50.62	64.09	1053.7	1543.0	0.50	4.15
1962-63	3.94	0.97	4.91	9.54	57.21	71.65	1285.0	1865.1	0.38	3.84
1963-64	4.67	1.12	5.79	10.20	66.35	82.34	1633.8	2324.5	0.35	3.11
1964-65	5.43	2.22	7.65	10.50	73.52	91.67	1820.7	2598.8	0.42	3.53
1965-66	6.66	2.27	8.93	12.05	79.49	100.47	2060.7	2921.6	0.43	3.44
1966-67	6.25	1.75	8.00	10.73	87.13	105.85	2306.5	3261.2	0.35	3.25
1967-68	6.37	1.30	7.67	10.70	104.31	122.68	2352.7	2455.5	0.33	5.00
1968-69	6.74	1.51	8.25	11.11	108.76	128.12	2509.8	3758.7	0.33	3.41
1969-70	6.94	2.02	8.96	15.62	119.57	144.15	2823.1	4200.1	0.32	3.43
1970-71	7.86	2.45	10.31	15.31	128.80	154.42	3206.8	4752.4	0.32	3.25
1971-72	9.03	3.52	12.55	25.14	145.90	183.59	3872.4	5575.2	0.32	3.29
1972-73	10.09	4.02	14.11	35.94	153.50	203.55	4509.7	6435.8	0.31	3.16
1973-74	10.57	4.79	15.36	35.78	183.90	235.04	5073.4	7388.6	0.30	3.18
1974-75	10.46	5.06	15.52	39.23	219.00	273.75	6321.7	9223.1	0.25	2.97
1975-76	11.65	5.11	16.76	53.73	233.90	304.39	7608.8	1181.7	0.22	2.72
1976-77	11.84	5.67	17.51	60.44	251.90	329.85	8270.9	12331.7	0.21	2.67
1977-78	12.77	5.56	18.33	48.47	308.00	374.80	8858.4	13237.2	0.21	2.83
1978-79	13.07	5.85	18.92	55.41	364.90	439.23	10525.1	15527.7	0.18	2.83
1979-80	14.05	6.83	20.88	64.47	376.10	461.45	11973.6	17683.1	0.17	2.61

Cont'd....

(1)	(2)	(3)	(4)	(5)	(6)
1980-81	16.31	6.51	22.82	67.43	419.34
1981-82 (RE)	17.00	6.75	23.75	75.00	-
Compound growth rate* (per cent per annum)	7.57	11.39	8.53	13.02	11.60

Note: * Upto 1980-81 for ED, GT and gross tax revenue of the Centre, and upto 1979-80 for Stamps and Registration and the Combined tax revenue of the Centre and the States.

(Rs crore)

(7)	(8)	(9)	(10)	(11)
509.59	13179.6	19694.5	0.17	2.59
-	15754.3	-	0.15	-
-	13.97	14.28	-	-

Sources: 1. Explanatory Memorandum on the Budget of Central Government - relevant issues

2. Reports on Currency and Finance, Reserve Bank of India, relevant issues.

GT, WT and Stamps and Registration to the combined tax revenue of the Centre and the States. The contribution of ED and GT to the tax revenue collected at the Central level is not only small — it never exceeded 0.5 per cent of the gross tax revenue of the Centre (i.e., before sharing with the States) — the share of the two taxes together in the tax revenues of Centre has declined steadily over the last two decades. The revenue from all taxes on capital and capital transactions (excluding taxes on capital gains) forms a larger percentage of the combined tax revenue of the Centre and the States but that proportion too has declined steadily over the years, from 4.4 per cent in 1960-61 to 2.6 per cent in 1979-80 (Column 11 of Table 1).

The decline in the significance of the ED and GT in the tax revenues of the government in India is due partly to the slow growth of their yield relatively to the growth of the total tax revenue of the Centre and of the Centre and the States combined and also due to the poor elasticity of the revenue from those taxes with respect to the determinants of their base such as growth of GDP, capital formation and appreciation in the value of assets. During the period under review, revenue from the ED grew at the rate of only 7.5 per cent per annum and that from the ED and the GT taken together, at the rate of 8.5 per cent per annum as against a growth rate of about 14 per cent in the gross tax revenue of the Centre. The revenue from the WT and Stamps and Registration grew at a faster rate (13 per cent and 11.6 per cent respectively) than that from the ED and the GT but the growth of the tax revenues of the Centre and the States taken together has been even faster (14.3 per cent).

While there has been some growth in the yield of the ED in current prices - though at a much lower rate than that of the total tax revenue of the government - in real terms the growth has been virtually insignificant. Deflated by the price index of the Central government's consumption expenditure (with 1960-61 as the base), revenue from the ED stood at a little over Rs 5 crore in 1980-81 as compared to Rs 3 crore in 1960-61 (Table 2). The revenue had gone up to over Rs 6 crore in 1972-73 and 1973-74 but declined subsequently. At 1960-61 prices, the total revenue from the tax on gifts and estates increased from Rs 4 crore to Rs 7 crore during the same period while the gross tax revenue of the Centre increased from Rs 909 crore to Rs 4074 crore and that of the Centre and States combined, from Rs 1350 crore to Rs 6088 crore. There can be no denying the fact that the yield of the ED and GT in India has been disappointingly low. While proposing the GT in India, Professor Kaldor had estimated the probable yield of the tax (at an average rate of 20 per cent) at not less than Rs 30 crore a year.[3/] Even as far back as 1921, Prof. K.T. Shah had estimated the likely yield of a succession duty in India at Rs 5 crore a year at an average rate of 10 per cent.[4/]

As a revenue source, the ED has not been very responsive to increase in the GDP. The buoyancy of revenue from the ED with respect to GDP works out to 0.677 for the period 1960-80 (Table 3). Not many changes were made in the base of the ED during the period which could

---

3/ Kaldor, N. (1956), para 92, page 52.

4/ Shah, K.T. (1921), p. 328.

TABLE 2

Revenue Receipts from Taxes on Capital and Capital Transfer (other than Tax on Capital Gain) and Total Tax Revenue of the Centre and the States (1960-61 to 1980-81) at Constant Prices

(Rs crore)

Year	Deflator	Estate duty	Gift tax	Total of estate duty and gift tax (3+4)	Wealth tax	Stamps and registration	Gross tax revenue of the Centre	Combined tax revenue of the Centre and the States
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1960-61	1.000	3.09	0.89	3.98	8.15	47.01	908.90	1350.41
1961-62	1.018	4.14	0.99	5.13	8.10	49.72	1035.07	1515.70
1962-63	1.028	3.83	0.94	4.77	9.28	55.65	1250.00	1814.27
1963-64	1.072	4.36	1.04	5.40	9.51	61.89	1524.07	2168.42
1964-65	1.108	4.90	2.00	6.90	9.48	66.35	1643.23	2345.49
1965-66	1.183	5.63	1.92	7.55	10.19	67.19	1741.92	2469.64
1966-67	1.271	4.92	1.38	6.30	8.44	68.55	1814.71	2565.84
1967-68	1.352	4.71	0.96	5.67	7.91	77.15	1740.16	1816.21
1968-69	1.380	4.88	1.09	5.98	8.05	78.81	1818.70	2723.72
1969-70	1.416	4.90	1.43	6.33	11.03	84.44	1993.71	2966.11
1970-71	1.461	5.38	1.68	7.06	10.48	88.16	2194.93	3252.85
1971-72	1.534	5.8	2.29	8.18	16.39	95.11	2524.38	3634.41
1972-73	1.594	6.33	2.52	8.85	22.55	96.30	2829.17	4037.50
1973-74	1.725	6.13	2.78	8.91	20.74	106.61	2941.10	4283.23
1974-75	2.179	4.80	2.32	7.12	18.00	100.50	2901.24	4232.70

Contd......

(1)	(2)	(3)	(4)
1975-76	2.304	5.06	2.22
1976-77	2.362	5.01	2.40
1977-78	2.512	5.08	2.21
1978-79	2.561	5.10	2.28
1979-80	2.837	4.95	2.41
1980-81	3.235	5.04	2.01

TABLE 2 (Contd.)

(5)	(6)	(7)	(8)	(9)
7.28	23.32	101.52	3302.43	4853.18
7.41	25.59	106.65	3501.69	5220.89
7.29	19.29	122.21	3526.43	5269.58
7.38	21.64	142.48	4109.76	6063.14
7.36	22.72	132.57	4220.55	6234.08
7.05	20.84	-	4074.06	6087.93

Source: Same as for Table 1
For deflator : See Text.

TABLE 3

Buoyancy of Revenue from ED, GT, WT, Stamps and Registration, Gross Total Tax Revenue of Centre and Combined Tax Revenue of the Centre and States, with Respect to GDP

(1960-80)

		Buoyancy Coefficient
1.	Estate duty	0.677
2.	Gift tax	1.002
3.	Total of ED and GT	0.760
4.	Wealth tax	1.137
5.	Stamps and registration	1.024
6.	Gross total tax revenue of centre	1.217
7.	Combined tax revenue of centre and States	1.239

have a substantial impact on the yield. The only notable one is the exemption for residential houses upto Rs 1 lakh granted in 1964. There was a sharp step-up in the marginal rates in the mid-sixties but its impact on revenue is difficult to determine as it could have provided an impetus for the splitting of estates through gifts and thereby inhibited the growth of the ED base. If allowance is made for the probable dampening effect of the higher rates on the base, the elasticity of the ED might turn out to be higher than its buoyancy but is unlikely to be more than 1. The elasticity of revenue from the ED would be less than unity also with respect to growth of capital in the country since gross domestic capital (at current prices) grew at the rate of over 13 per cent per annum during the period 1965-66 to 1977-78 while the revenue from the ED did not grow at more than 7.5 to 8 per cent or so. The buoyancy of the GT with respect to GDP is a little over 1 but that of the ED and GT combined is 0.76 as against 1.22 of the gross tax revenue of the Centre and 1.24 of the combined tax revenue of the Centre and the States.

If measured with respect to the appreciation in the value of capital assets, the buoyancy of none of the capital taxes would exceed 1. No reliable index of prices of assets, particularly real estate, is available on a regular basis. However, from reports appearing from time to time it seems that the appreciation in the value of real estates in cities like Bombay and Calcutta in the seventies was of the order of 25 to 30 per cent per annum (NIPFP, 1981, pp. 11-12). Even in small towns, the rate of increase in land prices seems to have been at the rate of 15-16 per cent. The index number of cost of construction of residential buildings for the low income groups published in

the Housing Statistics (Government of India, NBO, 1981, Table 9.6 quoted in NIPFP, 1981, p.60, f.n.6) shows an increase at the rate of about 12 per cent per annum in a relatively low cost state like Orissa during 1971-80. The growth of neither ED nor GT comes anywhere near these rates.

Taxation of gifts and inheritance has not been of much significance from the revenue angle in any country where these are in vogue. The share of these taxes in the total tax revenue of governments (excluding local governments) rarely goes beyond 2 per cent even in the developed countries where the direct taxes contribute a good proportion of the tax revenue (Table 4). In countries where direct taxes play a less significant role, the contribution of taxes on estates, inheritance and gifts is smaller (e.g., Pakistan, Philippines, Republic of Korea and Sri Lanka). The elasticity of these taxes to GDP is also found to be low in many countries and in some countries it is negative, e.g., UK and USA (Tait, A.A., 1982).

Despite their poor yield and elasticity, very few countries have thought it fit to do away with taxes on gifts and bequests altogether. For inheritance is known to be the most important factor underlying the concentration of wealth (Atkinson, 1972, Harbury and Hitchans, 1979). Moreover, it is generally accepted that taxation of income based on the principle of realization is inadequate to meet the requirements of equity and needs to be supplemented with a tax on capital. While opinion is divided among public finance theorists about the best way of taxing capital - some favour only an annual tax on wealth

TABLE 4

Proportion of Revenue from Taxes on Property, Inheritance and Gifts in the Total Revenue, Total Tax Revenue and Direct Taxes of the Government in Selected Countries in the Seventies

	As per cent of total revenue		As per cent of total tax revenue			As per cent of direct tax revenue	
	Taxes on pro-perty	Estate, inheri-tance and gift taxes	Taxes on pro-perty	Estate, inheri-tance and gift taxes	Direct tax revenue	Taxes on pro-perty	Estate, inheritance and gift taxes
Australia (1972-80)	0.44	0.36	0.50	0.40	69.40	0.72	0.58
India (1974-80)	0.78	0.16	0.95	0.19	24.68	3.84	0.78
Indonesia (1972-80)	1.28	1.22	1.37	1.31	75.19	1.82	1.74
Pakistan (1973-80)	0.28	0.07	0.34	0.09	14.66	2.32	0.59
Philippines (1972-80)	1.46	0.24	1.72	0.28	25.94	6.64	1.09
Republic of Korea (1971-80)	1.16	0.27	1.30	0.30	28.84	4.52	1.04
Sri Lanka (1970-79)	0.87	0.30	0.94	0.32	15.22	6.19	2.11
United Kingdom (1971-80)	1.84	0.94	2.11	1.08	68.22	3.09	1.58
United States (1972-80)	1.57	1.57	1.70	1.70	91.19	1.86	1.86
Thailand (1972-81)	1.22	-	1.34	-	18.83	7.13	-
Japan (1971-80)	-	-	-	-	-	3.81	2.86

Source: Government Finance Statistics Year Book (IMF, 1982) Volume VI.

(Flemming and Little, 1974) while others argue for taxation of only transfers of capital and capital gains (Kay and King, 1980)— not many among experts advocate total abolition of estate and gift taxes.

Considerations which led to the introduction of the estate duty and gift tax in India still remain valid. That taxes on inheritances and gifts have a useful role in a country with wide disparities cannot be possibly contested. At the same time, there can be hardly any point in retaining a measure which fails to produce any tangible result. Any judgment on the future of the two taxes therefore should proceed on a consideration of whether it has been of any help in bringing down or at least containing the disparities in the distribution of wealth, what underlies its low yield and whether it can be improved if administered with reasonable care and suitably reformed, and, whether the gain likely to be derived would be worth the cost to the community as a whole.

CHAPTER 2

IMPACT OF THE LEVY

Normal Incidence

Prima facie, the ED in India constitutes a potent instrument for levelling down concentration in the ownership of inherited wealth. The exemption limit which was originally fixed at Rs 1 lakh was reduced to a relatively low level of Rs 50,000 in 1960. The threshold remained at that level until the amendments made last year raised it to Rs 1,50,000. The marginal rates of duty are also among the highest in the world. Table 5 shows the rate structure in force from time to time since 1953. The maximum marginal rate was raised from 40 per cent to 85 per cent in 1964 and is still in force.

The average incidence of ED at selected levels of principal value[5] (PV) in 1960, and at present, at 1960 prices of assets and at their current value, is shown in Table 6. The current values were derived from column 1 of the table by applying the capital formation deflator implicit in the National Accounts Statistics (CSO). It will be seen that as a result of the upward revision of the rates in 1964 and 1966 the incidence had gone up at all levels of PV exceeding Rs 5,00,000 as compared to the incidence obtaining during 1960-64. For estates of Rs 50 lakh and above, the incidence had more than doubled, even after allowing for the relief of upto Rs 1 lakh given in 1964 for residential house property (column 3 compared to column 2 of Table 6). The amendments of 1982 raised the exemption limit but did not touch the rates. The incidence of duty at 1980 rates and at current rates after allowing for appreciation

5/ The assessed value of an estate net of permissible deductions, that is, the value on which the duty is leviable is referred to in the ED Act as the "principal value". There are however certain items of assets which are included in the PV but on which rebate is allowed at the average rate.

TABLE

Rate Structure of

Principal value of estate		1953	1960
On first	50,000	0.00	0.00
On next	50,000	0.00	4.00
On next	50,000	7.50	6.00
On next	50,000	10.00	10.00
On next	1,00,000	12.50	12.00
On next	50,000	15.00	15.00
On next	1,50,000	15.00	15.00
On next	5,00,000	20.00	20.00
On next	5,00,000	25.00	25.00
On next	5,00,000	25.00	25.00
On next	10,00,000	30.00	30.00
On next	20,00,000	35.00	35.00
Excess over	50,00,000	40.00	40.00

5

Estate Duty

(Per cent)

1964	1966	1982
0.00	0.00	0.00
4.00	4.00	0.00
8.00	10.00	0.00
8.00	10.00	10.00
15.00	15.00	15.00
15.00	15.00	15.00
15.00	25.00	25.00
25.00	30.00	30.00
40.00	40.00	40.00
50.00	50.00	50.00
85.00	85.00	85.00
85.00	85.00	85.00
85.00	85.00	85.00

TABLE 6

Nominal Incidence of Estate Duty and Gift Tax (As Per Cent of PV) at Selected Levels of Estates/Gifts in 1960 and 1982

Principal value (Rs) (at 1960-61 prices)	Incidence of duty on PV shown in column 1 at constant prices			Incidence of duty on PV shown in column 1 at 1981-82 prices			Incidence of gift tax		
	At 1960 rates	At 1980 rates*	At current rates* (w.e.f. 1.4.1981)	At 1960 rates	At 1980 rates*	At current rates* (w.e.f. 1.4.1981)	At 1960 rates	At 1982 rates	At 1982 rates after allowing for appreciation of assets due to inflation
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
50,000	0.00	0.00	0.00	6.14	4.24	0.00	4.00	7.78	17.09
1,00,000	2.00	0.00	0.00	10.19	10.97	9.13	4.89	11.32	21.09
2,50,000	6.40	4.67	0.00	16.80	23.75	23.11	7.83	17.45	27.95
5,00,000	10.40	11.75	10.00	21.72	40.12	39.82	11.12	21.26	41.74
7,50,000	13.60	18.00	16.92	25.30	55.51	55.31	14.05	24.16	52.84
10,00,000	15.20	21.33	20.56	27.72	63.04	62.89	15.56	25.63	58.39
15,00,000	18.47	27.29	26.79	31.66	70.46	70.37	18.69	30.40	63.93
20,00,000	20.10	32.74	32.37	33.75	74.13	74.06	20.28	35.29	66.70
50,00,000	28.04	64.02	63.88	37.50	80.68	80.65	28.11	59.11	71.68
1,00,00,000	34.02	74.62	74.55	38.75	82.84	82.83	34.05	67.06	75.54

Note: * After allowing for deduction of Rs 1 lakh on account of residential houses property allowed under Section 33(1)(n).

in the value of assets since 1960 is shown in columns 6 and 7 respectively; column 5 gives the incidence of the duty on the PV shown in column 1 at 1960 rates after allowing for the impact of inflation on asset values. While the incidence turns out to be higher in 1982 than in 1960 at all levels of PV above Rs 1,00,000 the increase in the burden seems to be due more to the increase in the rates than due to inflation. For instance, on an estate of Rs 10 lakh (at 1960 prices) the duty at present works out to 63 per cent in 1982 as against 15 per cent in 1960. Had there been no change in the rates, the incidence would have gone up to about 28 per cent in 1980 as a result of inflation (column 5) whereas, at the rates prevailing in 1980, the incidence turns out to be about 63 per cent. Similar increases are noticeable at other levels too. Of course the impact of the increase in the rates was exacerbated by inflation. Whatever be the factors which brought about the rise, such high levels of death duties, if effective, should serve to bring down the disparities in the distribution of wealth appreciably.

Impact on inequalities

The distribution of estates, net wealth and gifts assessed during the years 1964-67 and 1977-80 for ED, WT and GT among different brackets of PV/net wealth/taxable gifts is given in Table 7. The distribution has been worked out for blocks of 3 years in order to even out any bunching occurring in a year in any particular range of estate net wealth/gifts because of fluctuations in assessments from year to year. The table reveals that of the estates which were assessed for the ED during 1964-67, those worth Rs 5 lakh or more constituted roughly 3.5 per cent of the total number but accounted for nearly 25 per cent of the value of the estates. In the assessments made during 1977-80, the top 3 per cent of the estate owners accounted for

TABLE 7

Distribution of Estates, Gifts, and Net Wealth Assessed for ED/WT/GT

(1964-67 and 1977-80)

(Value in Rs lakh)

ange of value	Wealth tax				Estate duty				Gift tax			
	1964-65 to 1966-67		1977-78 to 1979-80		1964-65 to 1966-67		1977-78 to 1979-80		1964-65 to 1966-67		1977-78 to 1979-80	
	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
0 - 1	Nil	Nil	Nil	Nil	7267 (48.85)	5017.10 (20.39)	13711 (46.60)	10560.20 (22.11)	41240 (98.12)	4794.29 (73.36)	91637 (98.70)	11185.15 (78.73)
1 - 5	166552 (88.67)	366129 (63.32)	361215 (92.11)	692620 (66.69)	7089 (47.66)	13443.41 (54.64)	14782 (50.24)	29634.00 (62.05)	751 (1.79)	1329.35 (20.34)	1121 (1.21)	1987.13 (13.99)
5 - 10	12571 (6.69)	88863 (15.37)	18073 (4.61)	130118 (12.53)	378 (2.54)	2516.30 (10.23)	796 (2.71)	5375.98 (11.26)	30 (0.07)	187.26 (2.87)	53 (0.06)	362.40 (2.55)
10 - 20	7324 (3.90)	70211 (12.14)	10557 (2.69)	103675 (9.98)	108 (0.73)	1455.92 (5.92)	120 (0.41)	1606.12 (3.36)	10 (0.02)	132.61 (2.03)	25 (0.03)	367.30 (2.59)
Above 20	1381 (0.74)	53019 (9.17)	2290 (0.58)	112196 (10.80)	33 (0.22)	2171.44 (8.83)	16 (0.05)	582.76 (1.22)	1 (Neg.)	91.47 (1.40)	9 (0.01)	305.63 (2.15)
TOTAL	187828 (100.00)	578221 (100.00)	392135 (100.00)	1038609 (100.00)	14875 (100.00)	24604.17 (100.00)	29425 (100.00)	47759.06 (100.00)	42032 (100.00)	6534.97 (100.00)	92845 (100.00)	14207.61 (100.00)

Note: Figures within parentheses denote percentages of the total.

Source: Directorate of Inspection (R, S, P, and AR), *All India Estate Duty, Gift Tax and Wealth Tax Statistics*, (relevant issues), New Delhi.

about 16 per cent of the aggregate value of the estates. As for wealth charged to the WT, in the assessments made during 1964-67, taxpayers with net wealth of Rs 5 lakh or more accounted for a little over 11 per cent of the total number of assessments and about 36 per cent of the wealth. In the assessments made in 1977-80 about 8 per cent of wealth tax assessments accounted for about 33 per cent of net wealth assessed. There has thus been a trend towards a fall in the share of estates of Rs 5 lakh and above in the total assessed value of estates coming under the ED. In the wealth tax assessments, the proportion of taxpayers worth Rs 5 lakh or more seems to have decreased but their share in the net wealth assessed has not registered a commensurate decline.

The trend towards a lessening of concentration in inherited wealth is also confirmed by the decline in concentration ratios of assessed estates during the seventies as compared to the sixties (Table 8). The ratio came down from 0.484 in 1960-61 to 0.350 in 1978-79. There was a rise in the ratio in 1979-80 (0.396) but it is still significantly below the degree of concentration observed in the sixties. The concentration of assessed wealth also seems to have decreased but not markedly. The ratio has gone down from 0.376 in 1965-66 to 0.369 in 1979-80 while there was a sharp rise in 1978-79.

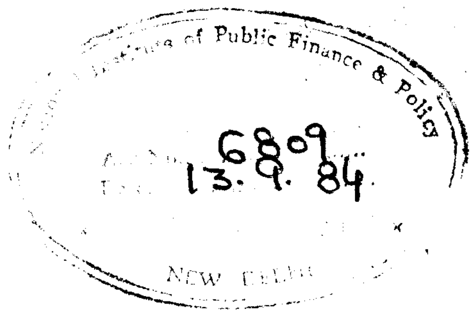
It may be objected that changes in the concentration of wealth among wealth-taxpayers or estates suffering ED cannot be taken to be conclusive evidence of trends in the distribution of wealth in the country as these data take no account of the distribution of wealth in the value

TABLE 8

Concentration Ratios of Estates and Wealth Assessed Under the ED and WT Acts

Year	Estates	Net wealth assessed to WT
1960-61	0.4840	-
1965-66	0.4160	0.3765
1970-71	0.4459	0.3279
1975-76	0.3775	0.3233
1978-79	0.3505	0.4509
1979-80	0.3956	0.3686

Source of basic data: Directorate of Inspection, All India Wealth Tax, Gift Tax and Estate Duty Statistics.



ranges below the taxable limit. Moreover, these figures relate only to wealth and estates reported to the tax authorities. Concentration ratios may have gone down simply because of evasion being practised on a wider scale by more resourceful wealth owners. It may also be argued that distribution of wealth is influenced significantly by many other measures apart from taxation such as ceilings on the holding of land, nationalisation of industries and so on and it is difficult to isolate the influence of any one factor to the exclusion of others. While the validity of these arguments cannot be denied, available data on the distribution of assessed estates do suggest, prima facie, a lessening of inequality in the ownership of inherited wealth in which the ED may have played a part. The degree of concentration of assessed wealth would probably have been accentuated had there been no duty on estates passing from one generation to another.

The proportion of estates in the upper value brackets may have come down because of the tendency on the part of the wealth owners to avoid the ED by splitting up their assets through gifts in their life time and other devices. But gifts beyond a limit also attract tax which serves to contain the growth of inequality in the ownership of wealth. Doubts about the efficacy of the ED in securing any appreciable change in the distribution of wealth arise from the fact that, apart from its low yield, the average incidence of the ED on assessed estates has been quite low and, in fact, did not go beyond 10-11 per cent of the estates passing on death in the 20 years ended 1979-80 except for two years as may be seen from Table 9. It is possible that the

TABLE 9

Average Incidence of Estate Duty for Different Categories of Estates*

(1959-60 to 1979-80)

(Per Cent)

Year	Entirely joint family	Partially joint family and partially other kinds	Entirely other kinds	All classes
(1)	(2)	(3)	(4)	(5)
1959-60	4.25	5.60	9.48	8.64
1960-61	2.81	6.62	6.91	6.54
1961-62	2.55	4.86	8.50	7.65
1962-63	3.10	5.23	7.79	6.96
1963-64	1.82	5.03	9.33	7.93
1964-65	2.13	3.93	6.69	5.80
1965-66	1.89	4.01	6.86	5.96
1966-67	8.23	4.84	11.07	9.86
1967-68	2.88	10.26	12.44	11.02
1968-69	3.18	5.53	8.79	7.40
1969-70	4.28	19.12	10.43	11.06
1970-71	3.87	6.83	10.51	9.40
1971-72	2.44	4.96	8.15	7.18
1972-73	3.08	6.28	9.21	8.26
1974-75	4.55	7.14	7.72	7.49
1975-76	4.37	6.55	8.15	7.78
1976-77	5.50	7.68	6.33	6.30
1977-78	5.64	7.23	6.78	6.77
1978-79	6.64	8.17	6.73	6.90
1979-80	7.72	7.81	8.14	8.07

Note: * On the Principal Value that is, after allowing for the permissible deductions.

Source of basic data: Directorate of Inspection, *All India Wealth Tax, Gift Tax and Estate Duty Statistics* (Financial Year Time Series) 1959-60 to 1979-80, New Delhi.

average incidence has been low despite high marginal rates in the top brackets because of concentration of estates in the lower ranges and paucity of high value estates coming under the ED or because the reliefs and rebates which serve to reduce the effective incidence are availed in the case of big estates on a relatively large scale. While such possibilities cannot be ruled out the causes of the low yield and incidence of the ED call for careful investigation.

CHAPTER 3

FACTORS UNDERLYING LOW YIELD AND INCIDENCE OF ESTATE DUTY

The low yield of a tax like the ED may result from either (a) a decline in the growth of collections relatively to demand, or (b) a decline in the growth of the demand for the tax itself. Demand for the ED may fail to grow when there is a fall in the mortality rates, or the base lacks elasticity because of leakages through evasion, avoidance or erosion through legislation and judicial interpretation, or the grant of reliefs and allowances on a liberal scale or intractable problems encountered in administering the implementing legislation or simply inefficiency.

a. <u>Elasticity of collections to demand</u>. Figures of ED assessments and the amount of demand raised in the years 1970-71 to 1981-82 are given in Table 10. The growth rate of demand raised during the period works out to 4.6 per cent per annum while that of collections comes to 6.9 per cent. The elasticity of collections with respect to demand works out to 1.47 which is statistically significant (at 1 per cent level). Although realization of death duties presents difficulty when, as is often the case, the liquid assets fall short of the amount required to pay the tax, the low yield of the ED cannot be attributed to any serious drag in collection. The proportion of collections to demand has remained fairly stable and in fact showed some improvement in the late seventies (column 9 of Table 10). The causes of low yield

TABLE 10

Number of Assessments and Demand Raised for ED

(1970-71 to 1981-82)

(Rs crore)

Year	Assessments				Demand			Total collection (Rs crore)
	Arear	Current	Total	Out of column (4) dutiable cases	Arear (Rs crore)	Current (Rs crore)	Total (Rs crore)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1970-71	6682	18274	24956	-	9.01	8.17	17.18	7.86 (45.75)
1971-72	5698	21244	26942	-	12.23	5.94	18.17	9.03 (49.70)
1972-73	5725	21751	27476	9041	9.89	9.41	19.30	10.09 (52.28)
1973-74	5960	22315	28275	8828	12.38	8.09	20.47	10.57 (51.64)
1974-75	6840	25920	32760	10982	10.96	7.09	18.05	10.46 (57.95)
1975-76	6510	28116	34626	16758	11.79	7.47	19.26	11.65 (60.49)
1976-77	8836	29017	37853	17162	13.28	6.90	20.18	11.84 (58.67)
1977-78	10374	29228	39602	16987	13.37	8.07	21.44	12.77 (59.56)
1978-79	9905	26657	36562	14344	13.77	7.75	21.52	13.07 (60.73)
1979-80	8267	24340	32607	12009	14.38	6.77	21.15	14.05 (66.43)
1980-81	9784	22644	32428	12137	14.42	13.68	28.10	16.31 (58.04)
1981-82	11609	23648	35257	-	14.41	18.07	32.48	20.31 (65.61)

Note: Figures within parentheses denote the collection as per cent of the total demand for collection.

* Revised estimate

Sources: 1. Explanatory Memorandum to the Budget of Central Government.

2. Directorate of Inspection (Research, Statistics and Public Relation) Monthly Progress Reports of Estate Duty, New Delhi.

have therefore to be looked for on the side of demand rather than collections.

b. Causes of lack of growth in demand. The growth of demand for tax depends on the number of effective assessments, the aggregate size of the base brought under taxation, the proportion of reliefs allowed in the tax otherwise payable and, for a progressive tax like the ED, the distribution of the base among the taxpayers. Figures of effective assessments (dutiable cases) under ED are not available for years prior to 1972-73. No reliable time-series are available for the base, viz., the PV of the estates, either. The All India Estate Duty, Gift Tax and Wealth Tax Statistics no doubt provides information on the PV assessed but its coverage seems to be incomplete and the extent of the coverage in a given year is not known.

(i) Leakages. Figures of dutiable cases completed annually since 1972-73 show that while there has been some increase, the number has fluctuated quite sharply from year to year (column 5, Table 10), and no clear trend can be discerned. It is therefore difficult to say whether lack of growth of demand is due to a slack in the rate of disposals. Even if the disposals fail to go up, the reasons may lie in a fall in the mortality rates. In any case it is difficult to judge from the number of assessments made in a year as such whether all cases liable to ED are being brought under assessment every year. However, a comparison of the figures of ED assessments with those of WT suggests that there may be leakages particularly in the upper value brackets affecting the growth of the base of the ED.

The proportion of assessments made under the ED Act and the value of estates assessed to the number of WT assessments and the aggregate value of net wealth worked out for two periods, one for the years 1964-67 (Period I) and the other for 1977-80 (Period II) is given in Table 11. The assessments for which the proportions have been worked out relate only to individuals in the case of WT and in the case of ED to estates consisting of assets belonging to the deceased in his/her individual capacity that is to say, estates which do not include any Hindu Undivided Family (HUF) property. Table 12 gives the proportion of ED assessments to assessments made under the WT Act for estates/wealth of all kinds (individuals, HUF, etc.) for the two periods.

Assuming that the mortality rate among wealth owners is not very different among the different value brackets of wealth, one would expect on an average the same proportion of wealth tax cases to come under the ED annually or over a given period in all brackets of wealth. Surprisingly, this is not the case. While there is some stability in the proportion of number of ED cases to the number of WT payers in Period I, in Period II the proportion varies markedly between different value brackets, from over 3 per cent in brackets of less than Rs 10 lakh to about 1 per cent in the brackets above. It is also striking that there has been a decline in the proportions of ED to WT assessments in the upper brackets in Period II as compared to the position in Period I. While a decline in the proportion of the number of estates coming under the ED and their value in the number of WT assessments and net wealth assessed in the last fifteen

TABLE 11

Proportion of Assessments under ED, and, ED and GT to Assessments under WT*

(Number and Value)

(1965-67 and 1978-80)

Assessed value of estate/ net wealth (Rs lakh)	ED assessments as per cent of WT assessments*				ED and GT assessments as per cent of WT assessments*			
	1964-65 to 1966-67		1977-78 to 1979-80		1964-65 to 1966-67		1977-78 to 1979-80	
	Number	Value	Number	Value	Number	Value	Number	Value
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1 - 5	3.28	2.91	3.53	3.68	3.75	3.30	3.85	3.98
5 - 10	2.71	2.56	3.68	3.53	2.99	2.82	3.95	3.79
10 - 20	1.60	2.27	1.05	1.42	1.77	2.50	1.25	1.72
Above 20	2.64	3.70	0.46	0.48	2.72	3.91	0.81	0.75
TOTAL	3.18	2.85	3.56	3.14	3.63	3.19	3.78	3.44

Note: * Relates to "Individuals" only. Source of basic data: All India Estate Duty, Gift Tax and Wealth Tax Statistics.

TABLE 12

Proportion of ED Assessments and Assessments made for ED and GT to Assessments under WT*

(Per cent)

Range of value (Rs lakh)	Assessments under ED as per cent of WT assessments				Assessments under ED and GT as per cent of WT assessments			
	1964-65 to 1966-67		1977-78 to 1979-80		1964-65 to 1966-67		1977-78 to 1979-80	
	Number of assessments	Value	Number of assessments	Value	Number of assessments	Value	Number of assessments	Value
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1 - 5	4.26	3.67	4.09	4.28	4.71	4.03	4.40	4.57
5 - 10	3.01	2.83	4.40	4.13	3.25	3.04	4.70	4.41
10 - 20	1.47	2.07	1.14	1.55	1.61	2.26	1.37	1.90
Above 20	2.39	4.10	0.70	0.52	2.46	4.27	1.09	0.79
TOTAL	4.05	3.39	4.01	3.58	4.47	3.69	4.32	3.87

Note: * Relates to all classes of taxpayers.

Source of basic data: All India Wealth Tax, Gift Tax and Estate Duty Statistics.

years is not implausible - as life expectancy has improved steadily in recent decades - the variation in the proportions as between the upper and in lower brackets appear to be too large to be explained away as accidental. The proportions in the upper value brackets in Period II are also way below the mortality rate of the population of the country which is now about 1.2 per cent per annum. Even granting that life expectancy may be higher among the wealthy, it looks highly improbable that the mortality of wealth tax payers could be as low as 0.46 or 0.48 per cent in any bracket. The relatively high figures of 3.53 and 3.68 for the lower brackets do not look unrealistic since many small estates which were never assessed to WT are reported for ED assessment in order to obtain clearance. The sample survey carried out for this study shows that only in about 28 per cent of the dutiable ED cases, the deceased happened to be a WT assessee although 59 per cent of them were liable to pay income tax (Table 13). But the low proportion of less than 0.5 per cent in the upper value brackets is clearly intriguing.

The comparisons attempted here suffer from several limitations since the threshold levels and exemptions for the ED and the WT are not identical. The coverage of published data on the ED and WT assessments is also not complete. But, in view of the fact that many cases are reported for ED which were not liable to WT and that the range of exemption in ED is narrower than under the WT, if anything, the proportion of ED to WT assessments should have been higher than the prevailing mortality rates. In the absence of any evidence of a dramatic decline in the mortality rates among owners of wealth worth Rs 20 lakh or more, the low proportion of ED

TABLE 13

Proportion of ED Cases where Deceased Assessed to Income Tax and Wealth Tax

(Number)

Centre	Income tax				Wealth tax			
	Assessed	Not assessed	No information	Total	Assessed	Not assessed	No information	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Ahmedabad	37 (75.51)	11 (22.45)	1 (2.04)	49	30 (61.22)	18 (36.73)	1 (2.04)	49
Bombay	62 (62.00)	37 (37.00)	1 (1.00)	100	31 (31.00)	68 (68.00)	1 (1.00)	100
Calcutta	45 (45.00)	55 (55.00)	0 (0.00)	100	15 (15.00)	79 (79.00)	6 (6.00)	100
Delhi	43 (49.43)	40 (45.98)	4 (4.60)	87	15 (17.24)	67 (77.01)	5 (5.75)	87
Kanpur	71 (69.61)	29 (28.43)	2 (1.96)	102	30 (29.41)	62 (60.70)	10 (9.80)	102
Grand Total	258 (58.90)	172 (39.27)	8 (1.83)	438	121 (27.63)	294 (67.12)	23 (5.25)	438

Note: Figures within parentheses denote percentage of the total.

Source: Sample Survey by NIPFP.

to WT assessments in the upper brackets suggests, *prima facie*, leakage either through avoidance or evasion.

It is possible that large wealth owners so arrange their affairs in their life time by giving away their assets or splitting them that only a fraction of their wealth remains to be assessed for ED when they pass away. An attempt was therefore made to see whether GT assessments make up for the shortfall in the number of ED cases and the value of assessed estates by examining what proportion of the WT assessments come under the ED and the GT taken together. The results are set out in columns 6 to 9 of tables 11 and 12. The proportions do show an increase but the increase in the upper brackets is not appreciable. Possibly, WT payers with relatively large wealth reduce the size of their wealth before their death through gifts and transfers over a period of years so that the incidence of tax is lower than what a large estate has to suffer. Perhaps this more than any other factor explains the slow growth of the ED base especially in the upper value brackets.

The possibility of evasion cannot also be ruled out especially with the increase in the maximum marginal rate from 40 to 85 per cent since the mid-sixties. As noted already, along with inflation, the increase in the rates casts a heavy burden on the legatees of large estates which cannot but accentuate the tendency to evade. However, instances of evasion of ED coming to light do not seem to be many. The total amount of penalty levied for concealment of ED in Bombay, which handles the largest volume of ED work in India, came to only Rs 8570 in the last

five years (1977-78 to 1981-82). The number of cases in which such penalty was levied was only 14. This and also the large number of GT cases involving gifts of relatively small sizes (less than Rs 1 lakh) coming up for assessment suggest that leakage of the ED duty is occurring probably more through avoidance than through plain evasion.

(ii) Decline in average assessed value of estates. Another striking feature of ED assessments over the last twenty years is that notwithstanding the steady appreciation in the value of assets, the average assessed value of estates has registered a decline in recent years (Table 14). The average value which was around Rs 1.72 lakh in 1960-61 and Rs 1.82 lakh in 1961-62, stood at Rs 1.61 lakh in 1978-79 and Rs 1.68 lakh in 1979-80. Decline in the mortality rates may lead to a fall in the aggregate value of the estates coming within the purview of the ED but does not explain the decline in the average value of the estates. Other things remaining the same, the possible reasons for the downward trend in the average value are : (i) widening of exemptions, (ii) an increase in the share of relatively small estates in the aggregate value of estates signifying less inequality, (iii) a change in the composition of the estates, assets with lesser potential for value appreciation (like cash and bank deposits) accounting for a larger proportion of the total, or (iv) problems of valuation tending to restrain any upward revision of asset values in alignment with market trends. As already noted, a substantial exemption - value of one residential house upto Rs 1 lakh - was introduced in 1964. While this may be one reason for the

TABLE 14

Average Assessed Value of Estates

(1960-61 to 1979-80)

(Rs lakh)

Year	Movable property in India	Movable property outside India	Immovable property in India		Total*
			Agricultural	Non-agricultural	
	(1)	(2)	(3)	(4)	(5)
1960-61	0.27	0.70	0.53	0.66	1.72
1961-62	0.30	1.88	0.47	0.63	1.82
1962-63	0.28	0.59	0.40	0.56	1.71
1963-64	0.25	2.00	0.42	0.57	1.69
1964-65	0.24	0.65	0.34	0.55	1.59
1965-66	0.26	0.49	0.43	0.54	1.56
1966-67	0.32	1.28	0.42	0.57	1.79
1967-68	0.32	1.28	0.45	0.59	1.73
1968-69	0.30	0.75	0.46	0.54	1.62
1969-70	0.32	4.64	0.55	0.68	1.79
1970-71	0.39	3.43	0.57	0.69	1.83
1971-72	0.34	0.76	0.50	0.50	1.53
1972-73	0.36	1.66	0.54	0.57	1.64
1974-75	0.40	0.75	0.63	0.58	1.55
1975-76	0.38	1.46	0.61	0.59	1.52
1976-77	0.37	0.71	0.67	0.60	1.47
1977-78	0.40	2.71	0.70	0.63	1.59
1978-79	0.45	1.17	0.78	0.64	1.61
1979-80	0.54	1.12	0.67	0.68	1.68

Note: * After deduction of rebates and allowances.

Source of basic data: All India Estate Duty, Gift Tax and Wealth Tax Statistics.

decline in the average value in that year as compared to earlier years, it cannot explain fully the lack of response in the average value of the estates to the appreciation in the capital values since then.

Table 7 shows that between 1964-67 and 1977-80 there has been an appreciable rise in the proportion of estates worth Rs 5 lakh or less in the aggregate assessed value of estates. The proportion has increased from 75 per cent in Period I to about 88 per cent in Period II while the proportion of the number of estates coming within these ranges remains the same (around 96 per cent of the total). This could be an important factor underlying the decline in the average value of the estates. The composition of the estates also has undergone significant changes as the proportion of immovables has declined from 43 per cent in 1960-61 to 28 per cent in 1979-80 (Table 15). Among the movable assets, again the proportion of cash including fixed deposits and the residual item "others" has increased while that of stocks and shares and business assets has gone down (Table 16). The proportion of "precious stone, jewellery and works of art" has increased but only from about 3 per cent to 5 per cent. The increase in the share of movable assets and that too of assets which are relatively insensitive to price rise, may however be the result rather than the cause of problems encountered in the valuation of appreciating assets like immovable property and equity shares in joint stock companies.

TABLE 15

Composition of Estates Assessed to Estate Duty
(1960-61 to 1979-80)

(Rs lakh)

	1960-61	1965-66	1970-71	1975-76	1979-80
1. Immovable property in India					
(i) Agricultural	555 (12.87)	925 (11.49)	1442 (11.31)	1979 (14.93)	1725 (11.65)
(ii) Non-agricultural	1316 (30.50)	2116 (26.29)	2973 (23.31)	2714 (20.48)	2377 (16.05)
Total	1871 (43.37)	3041 (37.78)	4415 (34.62)	4693 (35.41)	4102 (27.70)
2. Movable property					
(i) In India	2322 (53.82)	4194 (52.10)	6859 (53.78)	7860 (59.31)	10018 (67.64)
(ii) Outside India	75 (1.74)	42 (0.52)	275 (2.16)	60 (0.45)	28 (0.19)
Total	2397 (55.56)	4236 (52.62)	7134 (55.94)	7920 (59.76)	10046 (67.84)
3. Assessment made under Section 20-A	37 (0.86)	2 (0.02)	-	-	-
4. Net value of interest in joint family property	9 (0.21)	771 (9.58)	1205 (9.45)	639 (4.82)	661 (4.46)
5. Gross value of estates (1+2, 3&4)	4314 (100.00)	8050 (100.00)	12754 (100.00)	13252 (100.00)	14809 (100.00)

Note: Figures within parentheses indicate percentage of gross principal value of estates.

Source: All India Estate Duty, Gift Tax and Wealth Tax Statistics, (relevant issues)

TABLE

Composition of Movable Property

Item	1965-66	1970-71
Government securities	165.00 (3.89)	194.89 (2.73)
Stocks, shares and debentures	785.58 (18.53)	1265.24 (17.74)
Cash, including fixed deposits	602.31 (14.21)	1188.55 (16.66)
Life Insurance proceeds	317.64 (7.49)	549.77 (7.71)
Business assets including share in partnership and goodwill	1211.16 (28.58)	1920.10 (26.92)
Precious stones, jewellery and works of art	115.14 (2.72)	182.07 (2.55)
Household goods, vehicles, furniture, etc.	63.09 (1.49)	83.69 (1.17)
Slice of assets of controlled companies	8.35 (0.20)	46.89 (0.66)
Others	970.09 (22.89)	1702.20 (23.86)
TOTAL	4238.36 (100.00)	7133.40 (100.00)

Note: Figures within parentheses denote percentages of the total.

16

Assessed to Estate Duty

(Rs lakh)

1975-76	1976-77	1977-78	1978-79
476.52 (6.02)	659.01 (8.64)	598.25 (5.60)	381.56 (3.65)
875.60 (11.05)	741.50 (9.72)	916.20 (8.58)	1055.55 (10.09)
1332.09 (16.82)	1467.04 (19.23)	2125.67 (19.91)	2276.32 (21.77)
665.06 (8.40)	866.66 (11.36)	1047.90 (9.81)	805.39 (7.70)
1894.87 (23.92)	1602.47 (21.00)	1962.27 (18.38)	1901.60 (18.18)
356.39 (4.50)	441.19 (5.78)	553.18 (5.18)	531.62 (5.08)
115.00 (1.45)	149.19 (1.96)	181.62 (1.70)	108.44 (1.04)
33.30 (0.42)	30.47 (0.40)	49.70 (0.47)	51.27 (0.49)
2171.68 (27.42)	1672.43 (21.92)	3242.47 (30.37)	3345.54 (31.99)
7920.51 (100.00)	7629.96 (100.00)	10677.26 (100.00)	10457.29 (100.00)

Source: All India Estate Duty, Gift Tax and Wealth Tax Statistics, (relevant issues).

(iii) <u>Valuation and other problems in administration</u>. That valuation of assets constitutes the central problem in ED assessments is borne out by the fact that most of the differences between the PV assessed and the value of the estate returned by accountable persons arise out of differences in valuation. The sample survey shows that as much as 70 per cent of the variations are accounted for by differences in the valuation of movable and immovable assets. Valuation of movables accounts for 37 per cent and of immovables about 34 per cent of the difference while inclusion of properties/interest not shown in the return form 17 per cent and disallowance of liability about 10 per cent (Table 17). The aggregate amount of the additions made in the assessments to what was shown in the returns furnished by the accountable persons (APs) comes to about Rs 2.5 crore in a sample of 435 dutiable cases with aggregate PV of the order of Rs 11.81 crore completed during the years 1979-80, 1980-81 and 1981-82. The total number of dutiable assessments done during a year is about 12000. The total amount of additions made in the assessments thus may be around Rs 80 crore in a year in about Rs 300 crore of PV, that is accounting for about 25 per cent of the total assessed value of estates.

Of course, the additions made by the assessing officers are open to review by appellate authorities. Complete figures of the number of appeals filed are not available. From whatever could be gathered it appears that about 1500 to 2000 appeals are filed every year before the Appellate Assistant Commissioners and Commissioners of Income Tax (Appeal), forming about 12-15 per cent of the total number of dutiable assessments.

TABLE 17

Distribution of Differences Between Assessed Value of P.V. and Value as Per Return - According to Range of Variation

(Amount in Rs '000)

Variation (Rs '000)	Number of cases	Amount	Valuation of movable property		Valuation of immovable property		Inclusion of property/interest not shown in return		Disallowance of liabilities	
			Number	Amount	Number	Amount	Number	Amount	Number	Amount
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Zero and below zero	90 (20.69)	-1813 (-6.66)	12 (4.76)	81 (0.81)	15 (8.33)	444 (4.79)	0 (0.00)	0 (0.00)	1 (3.03)	30 (1.10)
1 - 10	84 (19.31)	379 (1.39)	69 (27.38)	329 (3.29)	21 (11.66)	324 (3.50)	4 (13.79)	19 (0.41)	4 (12.12)	10 (0.36)
11 - 25	62 (14.25)	1095 (4.03)	41 (16.26)	563 (5.64)	30 (16.66)	414 (4.47)	6 (20.68)	52 (1.12)	6 (18.18)	61 (2.25)
26 - 50	66 (15.17)	2447 (9.00)	44 (17.46)	1053 (10.55)	37 (20.55)	1123 (12.13)	4 (13.79)	33 (0.71)	4 (12.12)	39 (1.43)
51 - 75	40 (9.20)	2524 (9.28)	29 (11.50)	1129 (11.31)	22 (12.22)	911 (9.84)	3 (10.34)	34 (0.73)	2 (6.06)	7 (0.25)
76 - 100	22 (5.06)	1932 (7.10)	13 (5.15)	746 (7.47)	15 (8.33)	960 (10.37)	1 (3.44)	69 (1.49)	2 (6.06)	115 (4.24)
101 - 200	44 (10.11)	6595 (24.24)	29 (11.50)	2371 (23.77)	28 (15.55)	2650 (28.62)	3 (10.34)	131 (2.84)	6 (18.18)	688 (25.38)
201 - 350	14 (3.22)	3666 (13.48)	6 (2.38)	1268 (12.71)	5 (2.77)	533 (5.75)	1 (3.44)	140 (3.04)	2 (6.06)	81 (2.98)
351 - 500	6 (1.38)	2375 (8.73)	4 (1.58)	1153 (11.56)	3 (1.66)	765 (8.26)	2 (6.89)	163 (3.54)	2 (6.06)	27 (0.99)
Above 500	7 (1.61)	8002 (29.42)	5 (1.98)	1281 (12.84)	4 (2.22)	1133 (12.23)	5 (17.24)	3963 (86.07)	4 (12.12)	1652 (60.95)
TOTAL	435 (100.00)	37202 (100.00)	252 (57.93)	9974 (36.66)	180 (41.37)	9257 (34.03)	29 (6.66)	4604 (16.92)	33 (7.58)	2710 (9.96)

Note: Figures within parentheses barring those in line showing the total denote percentages of the respective column totals. Figures in brackets in the line giving the total are percentages of the total number and amount in column (2) and column (3) as the case may be.

Source: Sample Survey by NIPFP.

From discussions with the Assistant Controllers of Estate Duty at Bombay and Calcutta, it was learnt that most of the cases with assessed estates of Rs 5 lakh or more are contested. From the survey undertaken for the present study it seems that in about 75 per cent of the assessments going up in appeal at least 25 per cent of the additions made by the assessing officers is knocked off by the appellate authorities (Table 18). This does not include the reductions granted by High Courts and the Supreme Court.

To ease the task of valuation and reduce the scope for disputes, a system of "Approved Valuers" was introduced soon after the introduction of the ED. With the creation of the valuation cell, cases involving valuation of large properties are required to be referred to the Valuation Officer. Our sample survey showed that in about 36 per cent of the cases in which the valuation of immovable property was enhanced by the Assistant Controller of Estate Duty (ACED) that is, the assessing officer, over the returned value, an approved valuer's certificate was filed. The proportion of cases referred to the Valuation Officer was found to be small (less than 5 per cent). Valuations are done by the assessing officers themselves after taking into account the valuer's certificate wherever such certificates are filed. But in the face of widespread underreporting of true values in registered documents, municipal valuations based on the "fair rent" concept as required under the law in most parts of the country and liberalisation of valuation for WT purposes, the ACEDs who make the assessments in the first place can rarely succeed in sustaining property valuations even approximately near the prevailing market prices.

TABLE 18

Reduction in EP Assessments Allowed by Appellate Authorities

Range of reduction allowed (as per cent of additions made in assessments)	ITAT	AAC	CIT	AAC and CIT	Total of columns (1+4)
	(1)	(2)	(3)	(4)	(5)
More than 100	4 (10.26)	4 (5.26)	1 (2.22)	5 (4.13)	9 (5.63)
100	- (0.00)	2 (2.63)	- (0.00)	2 (1.65)	2 (1.25)
100 - 90	2 (5.13)	7 (9.21)	1 (2.22)	8 (6.61)	10 (6.25)
90 - 75	3 (7.69)	7 (9.21)	4 (8.89)	11 (9.09)	14 (8.75)
75 - 50	10 (25.64)	16 (21.05)	14 (31.11)	30 (24.79)	40 (25.00)
50 - 25	8 (20.51)	20 (26.32)	13 (28.89)	33 (27.27)	41 (25.63)
Less than 25	11 (28.21)	20 (26.32)	11 (24.44)	31 (25.62)	42 (26.25)
FV enhanced by appellate authorities	1 (2.56)	- (0.00)	1 (2.22)	1 (0.83)	2 (1.25)
TOTAL	39 (100.00)	76 (100.00)	45 (100.00)	121 (100.00)	160 (100.00)

Note: Figures within parentheses denote percentages of the total.

Source: Sample Survey by NIPFP.

The other category of assets which usually have some potential for appreciation are the equity shares of companies. Valuation of shares of quoted companies usually poses no problem. It is the unquoted shares which create controversies and provides scope for avoidance. In order to simplify the task of share valuation, instructions were issued in 1968, reversing the guidelines of 1965, asking the assessing officers to value the shares of unquoted companies on the basis of the book value instead of the market value of the assets of the company as is done for purposes of the WT. The result has been that shares of companies are often valued far below the break-up value of the assets at their current market value. This has encouraged wealthy taxpayers to transfer even personal assets like jewellery to corporate entities at low values so that the values of the shares in such companies bear no relationship to their real worth. Because of some doubt about its legality on a strict interpretation of the law, this approach was questioned by the Revenue Audit carried out by the Comptroller and Auditor General following which the instructions of 1968 were withdrawn in 1974 and the assessing officers were asked to proceed on the basis of the market value of the assets while valuing unquoted shares. But this attempt does not seem to have been very fruitful as one High Court has held that the rule of valuation of unquoted shares followed in WT should be adopted for purposes of ED too. (Mysore High Court in CED v. J. Krishnamurthy, 99 ITR 87). The method of valuation of unquoted shares is currently under review. Whatever be the outcome of the review, the rule of share valuation followed since 1968 could not but affect the ED base and dampen its growth.

Where the deceased is found to have transferred any assets to a "controlled" company — that is, a company which is under the control of not more than 5 persons or is a closely held company — there is a separate provision for assessing the interest of the deceased in the company with reference to the benefits derived by him in the last three accounting years. The same proportion of the assets of the company is deemed to pass in such a case as the proportion of the benefits derived to the total income of the company during the said three years. But the controlled company rules are notoriously complex and difficult to apply and seem to be invoked in very few cases. In our sample survey of dutiable cases application of controlled company rules was reported only in two cases.

With the recent amendment in the law extending the application of Rule 1BB of the WT Rules to valuation of one residential house property in ED assessments, it may be expected that there would be fewer disputes over valuation of real estates. The move to revise the method of valuation of equity shares should also help to ease the task of valuation in ED assessments. But with simplification of valuation procedures on these lines the growth of the base for ED will presumably be inhibited further.

(iv) Role of rebates and allowances. Valuation is not the only factor acting as a drag on the yield and efficacy of the ED in India. The ED Act provides relief by way of "rebates" and "allowances" on a number of items included in the PV and these serve to reduce the duty otherwise payable by about 12.15 per cent in the aggregate (Table 19). Of these the most important ones are the rebate

TABLE 19

Rebates and Allowances in ED

(1970-71 to 1979-80)

(Rs lakh)

Year	Gross duty payable	Relief on account of: Rebates – Total	Rebates – Of which: Agricultural lands in non-scheduled States	Rebates – Of which: Interest in HUF	Allowances – Total	Allowances – Of which: For quick succession	Allowances – Of which: On agricultural land	Allowances – Of which: For obtaining probate etc.	Allowances – Of which: Gift tax already paid on property included	Total relief	Relief as per cent of gross duty in column (1)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1970-71	1312	140	2.72 (1.42)	130 (67.71)	52	4.65 (2.42)	5.71 (2.97)	36.34 (18.93)	5.03 (2.62)	192	14.63
1971-72	900	96	3.07 (2.01)	77 (50.33)	57	0.26 (0.17)	15.35 (10.03)	33.68 (22.01)	7.83 (5.12)	153	17.00
1972-73	1019	97	2.46 (1.55)	80 (50.31)	63	1.06 (0.67)	22.78 (14.33)	31.24 (19.65)	7.00 (4.40)	159	15.60
1974-75	1118	92	2.37 (1.52)	79 (50.64)	64	0.23 (0.15)	12.24 (7.85)	38.65 (24.78)	12.56 (8.05)	156	13.95
1975-76	1100	76	1.62 (1.27)	63 (49.22)	52	0.47 (0.37)	13.10 (10.23)	28.12 (21.97)	9.86 (7.70)	128	11.64
1976-77	1004	102	1.72 (1.10)	87 (55.77)	54	0.72 (0.46)	12.60 (8.08)	26.74 (17.14)	13.69 (8.78)	156	15.54
1977-78	1377	120	11.19 (5.77)	93 (47.94)	74	1.35 (0.70)	14.13 (7.28)	24.70 (12.73)	32.65 (16.83)	194	14.09
1978-79	1295	89	5.94 (3.54)	67 (39.80)	79	0.95 (0.57)	12.99 (7.73)	37.88 (22.55)	26.59 (15.83)	168	12.97
1979-80	1377	86	5.24 (3.16)	71 (42.77)	80	1.90 (1.14)	8.94 (5.39)	63.69 (38.37)	5.53 (3.33)	166	12.06

Note: Figures within parentheses denote percentages of the total relief.

Source: All India Estate Duty, Gift Tax and Wealth Tax Statistics, (relevant issues).

on interest of lineal descendants in HUF property and the set-off for stamp duty apaid for obtaining probate, succession certificate etc. accounting for over 80 per cent of the total relief.

Since 1960 the interest of lineal descendants of the deceased in HUF property is aggregated in the PV of the estate but rebate is allowed on their interest so that the deceased's share alone in the HUF property is taxed. Thus the aggregation of the interest of the lineal descendants serves merely to raise the rate of tax on the deceased's estate. This applies to the estates of all persons governed by the Mitakshara school of Hindu law whereby a member of a HUF acquires an interest in the family property right from birth as a result of which interest in property passes at birth rather than at death. Aggregation of the lineal descendants' interest for rate purposes compensates only slightly for the leakage caused in ED by the operation of this rule.

The sample survey shows that in about 90 per cent of the ED cases the deceased happens to be a Hindu (Table 20) and of them, 62 per cent belong to the Mitakshara School (Table 21). In the last two decades, the proportion of estates comprising wholly or partly joint family property in the total number of estates has registered a sharp decline - from about 30 per cent in 1960-61 to about 13 per cent in 1979-80 - but the share of property wholly or partly owned by joint families in the total assessed value of estates remains surprisingly stable at about 20 per cent of the total (Table 22). Moreover many estates fall below the assessable limit

TABLE 20

Distribution of ED Cases According to Religion of the Deceased

	Proportion
Buddhist	1.66
Christian	2.84
Hindu	89.57
Muslim	2.61
Parsee	2.13
Others	1.18
TOTAL	100.00

Source: Sample Survey by NIPFP.

TABLE 21

Distribution of ED Cases According to School of Hindu Law

Item	Per cent of estates left by Hindus
Dayabhang	24.86
Mitakshara	62.43
Others	12.70
TOTAL	100.00

Source: Sample Survey by NIPFP.

TABLE 22

Proportion of Joint Family and Partly Joint Family in ED Assessments

(1959-60 to 1979-80)

(Per cent)

Financial year	Entirely joint family: In total number of estates assessed	Entirely joint family: In aggregate assessed value	Partly joint family: In total number of estates assessed	Partly joint family: In aggregate assessed value	Other kind: In total number of estates assessed	Other kind: In aggregate assessed value
	(1)	(2)	(3)	(4)	(5)	(6)
1959-60	21.09	7.58	9.40	11.51	69.51	80.91
1960-61	21.37	8.25	10.50	13.30	68.13	78.45
1961-62	11.40	5.68	16.23	14.14	72.37	80.18
1962-63	11.99	8.87	16.54	14.10	71.47	75.03
1963-64	13.40	9.96	15.96	15.27	70.64	74.77
1964-65	11.10	9.80	15.19	15.94	73.71	74.26
1965-66	10.64	9.18	14.61	15.65	74.75	75.17
1966-67	11.93	13.88	14.40	13.10	73.67	73.02
1967-68	13.95	11.63	13.09	13.96	72.96	74.41
1968-69	12.31	12.02	12.29	13.69	75.40	74.39
1969-70	8.42	8.50	12.04	13.33	80.54	78.17
1970-71	8.96	8.89	12.96	14.13	78.08	76.98
1971-72	9.15	8.30	13.77	15.70	77.08	76.00
1972-73	7.80	7.47	14.40	16.97	77.80	75.56
1974-75	3.63	4.62	10.78	14.18	86.74	81.20
1975-76	3.28	4.39	9.49	12.70	87.23	82.91
1976-77	4.74	7.19	8.85	13.16	86.41	79.65
1977-78	4.42	5.57	8.60	12.82	86.98	81.61
1978-79	4.87	5.53	8.53	11.84	86.60	82.63
1979-80	4.46	5.86	8.75	13.42	86.79	80.72

Source: Directorate of Inspection, All India Wealth Tax, Gift Tax and Estate Duty Statistics, Financial Year Time Series (1959-60 to 1979-80), New Delhi.

because of the operation of the Mitakshara law and their number remains unknown. Hence even though the proportion of cases involving HUF interest has gone down, the Mitakshara law continues to operate as a factor undermining the efficacy of the ED in India.

Relief for probate, etc. also constitutes one of the factors reducing the effective incidence of the ED. The scope of this relief was enlarged in 1960 from 50 per cent of the duty paid for probates etc. to 100 per cent and in some years, as in 1979-80, this accounts for over one-third of the total relief allowed from the duty payable otherwise. However, the relief for stamp duty for probate etc. essentially implies a transfer from the Central government's account to the States.

Avoidance of duty through gifts constitutes a more potent source of leakage of the ED. The number of gift tax assessments is currently in the region of 69000 a year (Table 23) as against 12,000 or so dutiable ED cases and, as may be seen from Table 7, nearly 99 per cent of the GT cases involve taxable gifts of less than Rs 1 lakh accounting for about 80 per cent of the gifts subjected to the GT. It is worth noting that a sizeable fraction (about 25 per cent) of the gifts are deducted from the base of the GT (Table 24) while a rather small proportion of the reliefs in ED is claimed on account of GT payment (column 9 of Table 19) which shows that most of the gifts are made well before the critical period which renders gifts inter vivos liable to be deemed to pass on death. Another possibility is that the gifts are made in such a way that very little of the wealth of rich persons remain with them at the time of their death.

TABLE 23

Assessments and Demand Raised in Gift Tax
(1970-71 to 1981-82)

Year	Number of assessment	Total demand (Rs crore)	Tax collection (Rs crore)	Tax collection as per cent of demand
	(1)	(2)	(3)	(4)
1970-71	34523	4.18	2.45	58.61
1971-72	42173	4.92	3.52	71.54
1972-73	48653	6.24	4.02	64.42
1973-74	55804	6.98	4.79	68.62
1974-75	65588	8.08	5.06	62.62
1975-76	74373	8.79	5.11	58.13
1976-77	76249	9.43	5.67	60.13
1977-78	71623	10.49	5.56	53.00
1978-79	81553	21.08	5.85	27.75
1979-80	63042	19.28	6.83	35.43
1980-81	60562	32.52	6.51	20.02
1981-82	68964	34.23	6.75	19.72

Source: Directorate of Inspection (Research, Statistics and Public Relations), Research and Statistics Wing, *Monthly Progress Reports*, New Delhi.

TABLE 24

Deduction as a Proportion of Gross Value of Estates in ED and of Gross Value of Gifts Assessed under GT

(1965-66 to 1979-80)

(Rs lakh)

Year	Estates			Gifts		
	Gross principal value	Deductions	Deductions as per cent of principal value of estates	Gross value of taxable gifts	Value of gifts exempted under Section (5), (1) and (2)	Column (5) as per cent of column (4)
	(1)	(2)	(3)	(4)	(5)	(6)
1965-66	8050	563	6.99	3135	942	30.05
1966-67	10126	663	6.55	2672	921	34.47
1967-68	10260	700	6.82	2650	1062	40.08
1968-69	8794	671	7.63	3436	1458	42.43
1969-70	9112	598	6.56	4323	1872	43.30
1970-71	12754	836	6.55	4265	1766	41.41
1971-72	11121	730	6.57	4594	1585	34.50
1972-73	11215	802	7.15	5186	1584	30.54
1974-75	13657	809	5.92	7153	2101	29.37
1975-76	13252	758	5.72	7919	2451	30.95
1976-77	13908	751	5.40	8135	2378	29.23
1977-78	18608	1108	5.95	7208	1984	27.52
1978-79	17361	1032	5.95	7923	1862	23.50
1979-80	14810	879	5.94	4113	1025	24.92

Source of basic data: All India Estate Duty, Gift Tax and Wealth Tax Statistics.

Relief is also admissible for the tax paid on capital gains when any part of the estate is sold within two years after death and the sale proceeds are utilised in paying the ED due. The amount of relief claimed under this head is not known. From the sample survey it appears that cases in which such relief is claimed are few.

Some relief is granted also for the value of agricultural land included in estates of not more than Rs 2 lakh. This relief is restricted to 25 per cent of the duty payable on the agricultural land in question. About 5 to 10 per cent of the reliefs are accounted for by this head (column 7 of table 19). While the reduction in the ED liability resulting from this provision does not seem to be large, absence of any definition of agricultural land in the ED Act sometimes creates problem in the categorization of vacant land. To overcome the problem, the Income-tax Act now provides a definition of what constitutes an agricultural land for purposes of capital gains. In the absence of such a definition, vacant lands located in urban areas are in some instances shown as "agricultural" with consequent reduction in ED payable on them.

(v) <u>Base erosion from judicial interpretation and amendments in law</u>. The base of the ED has suffered further erosion from judicial decisions and amendments bearing on some of the vital provisions of the ED Act designed to counter avoidance. Reference may be made particularly to the interpretation of Section 10 by the courts and the amendments thereto following in their wake resulting in the virtual withdrawal of a major anti-avoidance measure in the scheme of the ED Act.

Drafted on the lines of a similar provision in the UK Law, section 10 of the ED Act in its original form provided that a property gifted by a deceased shall be deemed to pass on his death even if the gift was made beyond the critical period of two years before death, that is, the period, during which all gifts made are deemed to pass, if (i) the donor is not excluded completely from the possession and enjoyment of the property or (ii) if he derives any benefit therefrom by contract or otherwise. This provision was considered necessary to thwart any attempt to avoid ED by transferring assets without divesting oneself of enjoyment and possession (e.g., by transferring one's house property to wife or children but continuing to live there as before). The courts in UK had put a fairly strict interpretation on the provision and had ruled that it would come into operation if the deceased continued in fact to be in possession or enjoyment of the property, directly or indirectly, no matter whether there was any reservation of interest for him by contract or otherwise. The Supreme Court also had favoured this interpretation in a case [George Da Costa v. CED (1967) 63 ITR 497]. But the law was amended in 1965 to provide that a house if gifted by the deceased to his/her spouse, son, daughter, brother or sister shall not be deemed to pass on the death of the donor merely by reason of the residence of the deceased therein unless the right of residence of the deceased is reserved or secured under the relevant disposition or any collateral disposition. It is also provided now that gifts made beyond 5 years before death to any of the relations mentioned above will not be included in the estate if gift tax was payable on the assets gifted (unless exempted

under the GT Act). While this ensures that properties gifted away during one's life time are at least subjected to the GT, the base of the ED gets eroded in the process. It is, therefore, not surprising that very few estates come up for assessment under the ED in the upper ranges.

Then there are the institutions like discretionary trusts and "Debuttar" or religious trusts. Discretionary trusts proved an intractable problem in the administration of ED in UK to such an extent that the levy came to be referred to there as a "voluntary tax". Apart from these trusts, in India the right to worship a deity and enjoy the fruits of looking after the property settled on a religious trust such as the right to reside in the properties settled on a deity has been held to be appurtenant to the office of "shebaitship" (worshipper) and therefore ED is not attracted on their passing on death, although, somewhat paradoxically, such offices are pronounced by the courts to be heritable and subject to the ordinary laws of succession, e.g., Calcutta High Court in Satyanarayan Bagla v. CED (1962) 133 ITR 710.

(vi) Administrative weaknesses. The slow growth of the base of the ED is partly attributable also to the weaknesses in the administration. The ED Act is a notoriously complicated piece of legislation, being modelled on the UK law which has since been replaced there by a new enactment levying the "Capital Transfer Tax". This, together with the absence of any time limit on the completion of assessments, results in delay in the completion of assessments of large estates which sometimes

drag on for more than ten years. The age-wise distribution of ED cases pending final assessment is given in Table 25. In Bombay alone over 400 cases with PV of more than Rs 10 lakh were found pending as of October 1982. Some of these are more than 10 years old.

A review of a few sample cases showed that formidable problems are sometimes encountered in the assessment of large estates and the difficulties are often compounded by disputes among persons accountable (APs) for the duty, court orders regarding title to certain properties and so on. The delay is however partly caused by the fact that the attention required for intricate cases is not always forthcoming as there is a natural tendency on the part of the officers to turn to relatively simple cases in order to present a better picture of their annual output of work. Necessary co-operation is also not always forthcoming from the APs as they tend to lose interest in getting the case completed once the provisional discharge certificate is issued.

One also wonders whether reports of all deaths involving dutiable estates are received regularly by the administering authorities. Intimation of deaths is received from various sources like the trustees of provident fund, the LIC, the assessing Income Tax Officers, etc. Information is also collected by the ED office from other sources like newspapers, municipal office etc. The sample survey however revealed that in 97 per cent of the dutiable cases, the file is started on receipt of intimation from the APs (Table 26). Evidently the other sources of information are not operative.

TABLE 25

Analysis of Pending ED Cases (Age-Wise)
As on 31.3.1981

Year	Number of assessments pending	Proportion to the total (per cent)
1976-77 and earlier years	7005	19.53
1977-78	4256	11.87
1978-79	5628	15.69
1979-80	7726	21.54
1980-81	11247	31.36
TOTAL	35862	100.00

Source: Government of India, *Report of the Comptroller and Auditor General of India*, 1980-81, New Delhi.

TABLE 26

Source of Death Report

Item	Dutiable estates		Exemption cases	
	Number	Per cent	Number	Per cent
Intimation by AP	426	97.26	892	99.55
Newspapers	1	0.23	3	0.33
PF authorities and LICI	6	1.37	1	0.11
Companies	1	0.23	0	0.00
Internal (ITO etc.)	1	0.23	0	0.00
Others	3	0.68	0	0.00
TOTAL	438	100.00	896	100.00

Source: Sample Survey by NIPFP.

CHAPTER 4

COST OF COLLECTION AND BURDEN OF COMPLIANCE

Collection Cost

The cost of administering the ED Act however is quite high relatively to that of other taxes. With slow growth of collections, the proportion of cost of administration to revenue from the ED is steadily going up and now stands at 7-8 per cent as compared to about 3 per cent for the income tax (Table 27).

Costs of Compliance and Harassment to APs

The cost of compliance too seems to be quite high. Over 54 per cent of the dutiable cases is handled by lawyers (Table 28). Even for obtaining exemption certificate the APs find it necessary to engage representatives (lawyers, etc.) in about 28 per cent of the cases.

Compliance with the requirements of the ED entails costs in other forms too, not all of which can be quantified as reliable information of such costs is difficult to gather. One factor which not only involves some cost but also can be a source of harassment to people of small means is the requirement in the ED Act that no probate or grant of representation shall be allowed unless a certificate of discharge from liability to duty is produced (section 55). Also, every trustee, in whom any interest in the property passing on the death of a person or its management is at any time vested, is liable to be treated as an AP (Section 53). By virtue of this provision trustees of provident funds usually ask for a clearance certificate

TABLE 27

Revenue and Cost of Collection of Income Tax and Estate Duty*

(1972-73 to 1981-82)

(Rs lakh)

Year	Income tax			Estate duty		
	Revenue	Cost	Cost as per per cent of revenue	Revenue	Cost	Cost as per cent of revenue
	(1)	(2)	(3)	(4)	(5)	(6)
1972-73	60200.00	1912.00	3.18	925.00	17.42	1.88
1973-74	57300.00	2429.00	3.61	1000.00	15.55	1.56
1974-75	74700.00	2821.00	3.78	1000.00	20.98	2.10
1975-76	106000.00	3309.00	3.12	925.00	84.03	9.08
1976-77	96500.00	3388.00	3.51	1075.00	86.00	8.00
1977-78	102500.00	3129.00	3.05	1100.00	90.00	8.18
1980-81	143000.00	4655.00	3.26	1450.00	118.00	8.14
1981-82	152000.00	5285.00	3.48	1700.00	133.00	7.82

Note: * Based on revised estimates of revenue and cost of collection.

Source: Government of India, Ministry of Finance, Explanatory Memorandum on The Central Government Budget, (relevant issues), New Delhi.

TABLE 28

Mode of Representation of Cases in ED

Item	Dutiable estates		Exemption cases	
	Number	Per cent	Number	Per cent
A P S	119	28.06	646	74.86
Lawyers	230	54.24	205	23.75
Both	75	17.68	12	1.39
TOTAL	424	100.00	863	100.00

Source: Sample Survey by NIPFP.

from the ED authorities before releasing the amount lying in the account of a deceased member. This compels the heirs of even low paid workers who die prematurely to go to the ED office and apply for clearance.

Recognising that this might give rise to hardship and harassment, instructions were issued by the CBDT authorising the release of upto Rs 25,000/- from provident funds without production of ED clearance certificate, subject to certain conditions. Besides, a one-page form has been prescribed for estates which fall below the dutiable level but require a discharge certificate for the release of funds, mutation of property etc. The understanding is that assessment of small estates for which an account is filed in this form will be completed speedily and discharge issued without undue delay. Nevertheless, an impression of delay and harassment to heirs of persons of small means persists (vide observations of the Estimates Committee in paras 3.21 to 3.27 of their Twenty-Ninth Report).

In order to ascertain whether there is any substance in this impression, one of the points on which the sample survey organised for this study attempted to obtain some information was, how long it takes on an average to get clearance certificate from the ED Authorities. For this purpose, a sample of a little over 800 exemption (i.e., non-dutiable) cases spread over the five centres mentioned earlier, viz., Ahmedabad, Bombay, Calcutta, Delhi and Kanpur, was drawn and the dates of filing of return and the issue of clearance certificate noted. The results are set out in Table 29.

TABLE 29

Time-Lag Between Filing of Return and Issue of Clearance Certificate

(Exemption Cases)

(Number)

Time-lag/Centre (in days)	Ahmedabad	Bombay	Calcutta	Delhi	Kanpur	Total	Cumulative percentage of the total
Zero	178 (87.68)	20 (10.05)	9 (4.69)	13 (6.01)	16 (31.03)	256 (28.67)	28.67
1 - 7	10 (4.93)	70 (35.18)	4 (2.08)	64 (36.07)	42 (36.21)	190 (21.28)	49.95
8 - 15	8 (3.94)	39 (19.60)	9 (4.69)	26 (14.21)	12 (10.34)	94 (10.53)	60.48
16 - 30	3 (1.48)	22 (11.06)	25 (13.02)	17 (9.29)	6 (5.17)	73 (8.17)	68.65
31 - 90	3 (1.48)	24 (12.06)	77 (40.10)	38 (20.77)	10 (8.62)	152 (17.02)	85.67
91 - 180	1 (0.49)	13 (6.53)	43 (22.40)	12 (6.56)	6 (5.17)	75 (8.40)	94.07
181 - 270	0 (0.00)	2 (1.01)	11 (5.73)	8 (4.37)	0 (0.00)	21 (2.35)	96.42
271 - 365	0 (0.00)	2 (1.01)	4 (2.08)	1 (0.55)	2 (1.72)	9 (1.01)	97.43
366 - 730	0 (0.00)	6 (3.02)	10 (5.21)	4 (2.19)	0 (0.00)	20 (2.24)	99.67
More than 730	0 (0.00)	1 (0.50)	0 (0.00)	0 (0.00)	2 (1.72)	3 (0.34)	100.00
TOTAL	203	199	192	183	116	893	

Note: Figures within parentheses denote percentages of the total.

Source: Sample Survey by NIPFP.

The survey reveals that on the whole in about 50 per cent of the non-dutiable cases, the ED clearance is issued within a week, and in about 70 per cent within a month. In about 5 per cent of the cases, the time taken to obtain a clearance certificate goes beyond six months. There are marked variations in this picture among the centres, as for example, in Calcutta, the time lag is larger than in the other centres, while in Bombay, the clearance is issued in the course of the day of the filing of the return in about 88 per cent of the cases. The broad picture that emerges is that while there is some delay in a few cases (5 per cent), clearance is given by and large within a reasonable period.

In the case of dutiable estates, however, it takes longer to obtain a discharge certificate. Only in about 13 per cent of the cases discharge is given within 3 months and in about 30 per cent, within a year. In nearly 20 per cent of the cases it takes more than 2 years to get cleared of estate duty (Table 30). An analysis of the causes of the delay in dutiable cases shows that adjournments asked for by the APs accounts for 64 per cent of the delay while in 30 per cent the issue of discharge is held up on account of enquiry by inspectors (Table 31). It would, therefore, appear that while delay and thus hardship is sometimes faced in getting a clearance certificate even for an estate below the dutiable limit, delays occur more in the case of dutiable estate although it is partly attributable to lack of response from the APs. Clearly there is some room for improvement.

TABLE 30

Time-Lag Between Filing of Return and Issues of Clearance Certificate

(Dutiable Cases)

(Number)

Time-lag/Centre (in days)	Ahmedabad	Bombay	Calcutta	Delhi	Kanpur	Total	Cumulative percentage of the total
Zero	1 (5.88)	1 (1.52)	0 (0.00)	2 (8.00)	0 (0.00)	4 (1.97)	1.97
1 - 7	1 (5.88)	2 (3.03)	1 (1.32)	1 (4.00)	0 (0.00)	5 (2.46)	4.43
8 - 15	0 (0.00)	2 (3.05)	0 (0.00)	1 (4.00)	0 (0.00)	3 (1.48)	5.91
16 - 30	2 (11.76)	10 (15.15)	1 (1.32)	3 (12.00)	2 (10.53)	18 (8.87)	14.78
31 - 90	1 (5.88)	13 (19.70)	7 (9.21)	6 (24.00)	4 (21.05)	31 (15.27)	30.05
91 - 180	0 (0.00)	7 (10.61)	10 (13.16)	3 (12.00)	4 (21.05)	24 (11.82)	41.87
181 - 270	1 (5.88)	5 (7.58)	7 (9.21)	1 (4.00)	5 (26.32)	19 (9.36)	51.23
271 - 365	1 (5.88)	8 (12.12)	11 (14.47)	1 (4.00)	0 (0.00)	21 (10.34)	61.57
366 - 730	4 (23.53)	9 (13.64)	21 (27.63)	5 (20.00)	1 (5.26)	40 (19.70)	81.27
More than 730	6 (35.29)	9 (13.64)	18 (23.68)	2 (8.00)	3 (15.79)	38 (18.72)	100.00
TOTAL	17 (100.00)	66 (100.00)	76 (100.00)	25 (100.00)	19 (100.00)	203 (100.00)	

Note: Figures within parentheses denote the percentages of the total.

Source: Sample Survey by NIPFP.

TABLE 31

Causes of Delay

Item	Per cent of the total
Adjournments asked for by APs	62.90
Enquiry by Inspectors	30.11
Delay in payment	2.69
Others	4.30
TOTAL	100.00

Source: Sample Survey by NIPFP.

So far as small estates are concerned, following an undertaking given to the Estimates Committee, the CBDT has recently modified their instructions issued in 1975 regarding the responsibility of trustees of provident funds in releasing moneys to the credit of a deceased member and relaxed the conditions somewhat. Even so, the APs have to file an indemnity bond before the provident fund authorities and an affidavit declaring that the estate does not attract ED. In order to remove the hardship of heirs of small estates, a modification of the relevant law seems needed so that the PF authorities are absolved of all responsibilities while releasing balance not exceeding a certain limit.

In addition, the forms and procedures for obtaining clearance in the case of small estates may be streamlined and made simpler so that APs can appear before the ED authorities themselves and do not have to engage the services of intermediaries. It was found from the survey that in about 30 per cent of the non-dutiable cases grant of representation in some form or succession certificate is needed. Hence even in such cases, an ED clearance is needed. For the administration of the duty a provision requiring production of ED discharge for probates etc. cannot perhaps be dispensed with altogether. The only alternative is to ensure that clearances are issued in small cases expeditiously in all centres of the country.

The cost of compliance is sometimes aggravated by inordinate delays in the completion of assessments, finalisation of appeals, rectifications etc. As noted earlier, the proportion of appeals, though quite large, does

not seem to be unduly high considering the complications which arise in ED assessments. The figures of rectifications are not available for all centres. Information obtained from Bombay showed that most of the requests for rectifications are attended to within the same year.

Harassment, however, sometimes arises from reopening of cases following change of opinion on the part of the assessing authorities in matters vitally bearing on the assessment. A glaring example is provided by the change in the mode of valuation of unquoted shares followed in ED assessments in the course of a few years. Guidelines were first issued in 1965 for valuation of unquoted shares for purposes of the ED on the basis of the market value of the assets and not their book value. In view of the differences arising in the valuation of shares for ED and WT purposes, administrative instructions were issued in 1968 laying down that the valuation of assets for ED should be made generally on the same basis as followed in WT assessments, i.e., on the basis of book values of assets. In 1974, following the audit objection, these instructions were withdrawn and the original circular of 1965 restored. By further instructions issued in 1976, assessing officers were asked to reopen cases which had already been completed under the instructions of 1968, that is, by following the WT rules. The entire matter, it is understood, is under re-examination. However, as many as [illegible] cases were reopened as a result of the change of opinion of which 53 arose in Bombay alone. Such instances can be multiplied.

Whatever be the merit of the audit objection, change of opinion such as this obviously causes harassment and provides grounds for justifiable complaints.

Conclusions and Policy Implications

The review presented here (part I) shows that despite its poor yield the ED seems to have acted as a restraining influence on the growth of inequalities in the distribution of inherited wealth in the country, if not reducing them. Several factors have however operated to dampen the growth of the base of the ED and thereby undermine its yield and efficacy. Of these the important ones are, avoidance through gifts, operation of the Mitakshara law of succession, transfer of assets to corporate entities and trusts, liberalisation of valuation rules for immovable property and equity shares, base erosion through judicial rulings and legislation weakening some of the anti-avoidance provisions of the law. While it may not be possible to overcome all the problems which constrain the growth of the ED base, consideration may be given to measures which may help to strengthen the structure of the ED without disturbing the basic framework.

To the extent ED is avoided through gifts which are subjected to GT, transfer of assets within one's life-time cannot be regarded as a costless device for "avoidance" of ED. Unlike in the UK , ED in India has been operating alongwith the GT since 1958. The rates of the GT are also higher than those of the ED at several levels and as Table 32 would show, the actual incidence of the GT has been higher than that of the ED at all levels. Nevertheless, the preponderance of gifts of relatively

TABLE 32

Comparative Incidence of ED and GT

(Per cent)

Range of value (Rs lakh)	Estate duty			Gift tax		
	1977-78	1978-79	1979-80	1977-78	1978-79	1979-80
Upto 0.5	-	-	-	5.59	5.76	6.10
0.5 - 1.0	1.12	1.08	1.16	9.71	9.86	9.62
1.0 - 1.5	2.94	2.48	3.02	12.58	12.61	14.27
1.5 - 2.0	4.78	4.29	4.80	14.37	15.00	14.30
2.0 - 3.0	6.40	7.66	6.50	19.10	16.50	13.57
3.0 - 5.0	8.99	9.96	9.53	20.66	19.42	19.54
5.0 - 10.0	16.30	19.02	15.16	20.57	21.89	29.43
Above 10.0	26.98	33.30	33.99	37.15	39.05	-

Source of basic data: Directorate of Inspection, *All India Wealth Tax, Gift Tax and Estate Duty Statistics*, New Delhi.

small sizes (less than Rs 50,000) and the fact that in reality few estates suffer tax at the highest rates prescribed in the law suggest that a good part of the large estates probably suffer taxation at rates much lower than those which would have been applicable had those estates remained intact at the time of the owner's death. Avoidance of the ED and the diminution of large estates in this way would not be a matter for concern had this led to a genuine redistribution of wealth. In all probability this is not the case as transfers take place usually within the family. Therefore, if the ED is to achieve its objective it is necessary to integrate the schemes of the ED and GT more closely than at present. First, the rates of GT in the initial slabs may be stepped up from the present 5 and 10 per cent to 10 and 15 per cent and correspondingly in the upper ranges. Secondly, gifts made within seven years before death may be cumulated with the estate left by a deceased for purposes of the ED, with, of course, full set-off for the gift tax paid. Even at present gifts made over a period of five years are cumulated for the GT. A similar recommendation was made by the Choksi Committee also. However, in order to remove hardship the basic exemption allowed in the GT may be raised to allow for the impact of inflation on asset values.

The base of the ED also needs to be strengthened in several directions. Lines on which measures could be taken to strengthen the base are considered at some more length in Part II. One area which calls for immediate attention is the problem of valuation. Measures for simplification and liberalisation, such as

extension of the WT rules to house property valuation as provided under the recent amendments, do not seem to be fully justified as they seriously weaken the ED base. Since it is available irrespective of the size or value of the property, such liberalisation, while easing hardship in some cases, creates fresh inequities. If felt necessary, the scale of exemption for one residential house may be raised from Rs 1 lakh to Rs 2 lakh. Similarly, valuation of unquoted shares should, as far as possible be made in such a manner as to reflect their real worth.

As for exemptions and reliefs, there can be no justification for cutting down the reliefs admissible on account of stamp duty paid for probates and letters of administration. The set-off allowed for gift tax paid in respect of gifts included in the PV of an estate also cannot be questioned in equity. The rationale for setting off the tax on capital gains derived from assets sold away for meeting ED liability however needs some reconsideration. At present, the whole of the capital gains tax can be set off against ED, provided the entire sale proceeds of the asset in question are applied towards the payment of the ED. This provision is evidently liable to misuse as it is very difficult to ensure that the ED in a particular case has been paid entirely out of the sale proceeds of an asset even though other liquid assets were available.

Something ought to be done also to counteract the impact of the Mitakshara law of succession on the ED. While a completely satisfactory solution to this problem is not easy to devise, one way of redressing the inequality arising out of variations in ED liability as between persons belonging to different schools of Hindu

law can be to aggregate the shares of the lineal decendents of the deceased, as is being done now. However, while working out the tax payable, the dutiable part of the estate may be put on the top slab in the same manner in which agricultural and non-agricultural incomes of income tax payers are integrated at present for determining the tax payable on non-agricultural incomes.

While strengthening the base of the ED a fresh look may be taken also at the rate structure. Marginal rates going upto 85 per cent are scarcely wholesome for the administration or equity of any tax.

Steps should also be taken to simplify the procedure for obtaining clearance certificate for non-dutiable estates in order that the hardship to heirs of small estates is minimised. It should be recognised however that there is a trade-off between simplification and streamlining of procedures and rules of assessment such as valuation to remove hardship on the one hand and the yield and efficacy of the tax on the other. Therefore, while every attempt should be made to simplify the procedures and remove avoidable complexities in the law, the social costs in terms of revenue loss and, what is more, the adverse effects on the potency of the tax to achieve its objectives should be carefully weighed.

CHAPTER 5

THE CASE FOR TAXATION OF CAPITAL AND CAPITAL TRANSFERS

Introduction

The review of the operation of the estate duty (ED) in India presented in Part I shows that although its contribution to revenue has not been very significant, the ED seems to have had a restraining effect on the growth of inequality in the ownership of wealth in the country. The review also shows that the GT has served as a useful complement to the ED by reducing the scope for avoidance through lifetime transfers. The complaints of harassment also seem to be somewhat exaggerated though no doubt administrative delays may have caused hardship in some centres. However, in their present form, the two taxes suffer from several weaknesses and anomalies which have tended to undermine their efficacy as well as equity. Reform is needed in several directions if these taxes are to serve their objectives efficiently and equitably.

Doubts about the efficacy of the ED arise from the fact that apart from its poor yield, it has not been able to touch the really large estates. Between 1960-61 and 1979-80, the total number of estates of assessed value of more than Rs 50 lakh does not seem to have exceeded 50 or so (the average number of such estates assessed per year between 1965-66 and 1979-80 is about 2). The number of wealth tax payers with net wealth of Rs 50 lakh or more was well over 100 in the early sixties. Evidently, not even 50 per cent of estates of Rs 50 lakh or more have come under the ED even in the course of 20 years. The present study shows that over the years, the proportion of estates in the

upper brackets coming under the ED to the number of wealth tax payers in the corresponding ranges of net wealth has sharply declined. At the same time, there has been a tremendous increase in the real burden of the duty at almost all levels because of inflation. Reliefs provided by fresh exemptions (such as for a residential house) and increase in the threshold limit have not made much difference. The operation of a number of other taxes on capital (in addition to a progressive tax on income) has tended to aggravate the inequity. Apart from the local property taxes, there is an annual tax on net wealth exceeding a specified limit. Capital gains are liable to be taxed. Transfers of property have to bear tax also in the form of stamp duties and registration fees. Although relief is provided in ED for some of the taxes paid on the same assets under other legislations, the simultaneous operation of so many taxes on capital causes justifiable misgivings about their equity and economic effects. Hence the aims of taxing capital need to be defined with some clarity and the relative merits of alternative forms of capital tax considered before proceeding to explore the possible lines of reform of the existing taxes on capital transfers.

The Case for Taxation of Capital and Capital Transfers

a. Arguments for taxation of capital. Considerations which are usually put forward in support of capital taxation may be grouped broadly under three heads, viz., equity, efficiency and equality (Sandford, C.T., 1971). A supplementary advantage of having a capital tax where the income is also taxed is that information on wealth if obtained regularly greatly facilitates the administration

of the income tax through cross-checking of income from property as also from all sources. The case for a tax on wealth rather than or in addition to the tax on income is however based principally on considerations of horizontal equity, efficiency in resources use and reduction in the inequality of wealth (Sandford, C.T., Willis, J.R.M. and Ironside, D.J., 1975).

The equity case for taxing wealth instead of or in addition to income rests essentially on a two-fold argument. First, possession of wealth confers certain benefits such as independence, security and influence which cannot be related to any monetary return. Moreover, unlike the earnings of labour, income from capital does not decline with age. Nor does the enjoyment of such income involve any sacrifice of leisure (Meade Report, Ch. 15). The "reserve power" argument for taxing wealth was put forward most persuasively by Kaldor by citing the exemples of a beggar and a millionaire possessing a hoard of gold. Going by the income criterion neither the beggar nor the millionaire can be taxed though, apparently, their taxable càpacity cannot be rated as the same.

The other limb of the equity case rests on the problems of measuring income in a way which could reflect true differences in the economic power of taxpayers. It is almost universally recognised that the concept of income envisaged by economists, following the formulations of Haig and Simons, - the net accretion to economic power concept, - cannot be implemented in practice and the income tax has to be levied only on "realized" income. This unavoidably creates a lacuna which cannot be plugged adequately by taxing capital gains as and when they are realized. For taxation of

capital gains when realized gives rise to problems which defy a satisfactory solution. Sifting real from illusory gain proves virtually impossible in the real world, especially under conditions of uncertainty and inflation. Imperfections of the real world markets also distort the relation between income and the value of assets. Hence, it is argued that the income tax should be supplemented by a tax on capital. Some (Flemming J.S., and Little, I.M.D. 1974) go further and argue for total replacement of the tax on income and realized capital gains by a tax on wealth.

The efficiency case for wealth tax points to the disincentive effects of progressive taxation of income on the desire to work, save and take risks. If levied without distinctions, a tax on capital, it is thought, should correct the distortions created by the income tax with its unavoidable soft treatment of certain categories of income like capital gains and induce the optimum use of capital by wealth owners. In so far as it excludes human capital (which cannot conceivably be valued with any degree of reliability unless there is an efficient slave market), a net wealth tax encourages investment in education and training rather than in physical capital. Even when the wealth is invested in physical capital, a net wealth tax tends to be neutral between risky and non-risky investment than under the income tax and puts less premium on liquid assets with consequent effects on interest rates (Prest, A.R., and Barr, N.A., 1979).

Then there is the objective of reducing inequality in the ownership of wealth. In fact the principal objective underlying a tax on wealth usually is to promote equality and prevent the growth of concentration in the distribution of

wealth. A progressive annual wealth tax and a progressive transfer tax on wealth, the former more than the latter, is believed to act as a strong incentive for wider dispersal of wealth. An annual wealth tax encourages the dispersion of not only inherited wealth but also wealth accumulated out of one's own savings.

The case for net wealth taxes has been argued cogently from several angles by Thurow (Thurow, L.C., 1972). It is contended by him that from the social welfare approach, given the social concerns about both the level and distribution of the two main sources of personal benefit, namely, consuming goods and services and exercise of power to control economic resources, taxes (positive and negative) ought to be levied on both consumption and wealth. Approaching from the individual utility function angle, Thurow has argued that individual utility is maximised when the marginal benefits from consumption, physical capital and human capital are equal, and therefore, an individual should be taxed at some common rate on each. Therefore the proper tax base according to this line of argument is consumption plus wealth. Finally, efficiency considerations also call for a tax structure covering all major forms of economic activity. Hence, in theory it is necessary to tax consumption, earnings, physical wealth and leisure. It is thus concluded that a comprehensive set of taxes rather than reliance on any one tax is desirable.

b. The counter-arguments: The arguments for replacing the income tax by a tax on wealth, though appealing in principle, have not gained unqualified acceptance either among policy makers or by public finance experts.

The equity argument is countered by pointing out that not all ingredients of reserve power can be related to any monetary valuation of wealth (Kay, J.A. and King, M.A.,1980). If income in monetary form is inadequate for measuring such ingredients, it is unlikely that the market value of wealth would capture them. It is also argued that a strict application of the comprehensive income concept even when relying on the principle of realization should embrace the receipt of all gifts and inheritances in the base. As for accumulations out of one's earnings, taxing wealth accumulated out of one's savings from income which has already suffered taxation is not fair since the income tax systems in any event entail a heavier tax burden in present value terms on a taxpayer who saves than on one who never saves. Even under an expenditure tax regime, where savings are not taxed, the equity of imposing a special tax on own-accumulations in order "to cope with reserve power" is questionable (Prest and Barr, 1979).

The efficiency case for an annual wealth tax also should not be overstated. A highly progressive wealth tax cannot but affect the incentive to save especially under a system of income taxation. Hence, under such a tax regime exemptions have to be provided for savings in specified forms if the tax system is not to act as a drag on the growth of savings. The point is particularly relevant for developing countries trying to step up their rate of saving and investment. The exemptions provided from the wealth tax in India reflect the anxiety to neutralise the disincentive effects of taxation on savings. However, exemptions which unavoidably tend to be selective, create distortions unless their scope is wide and not restricted to certain specified assets. The point about

neutrality between risky and non-risky investment is also countered with the argument that the substitution of a capital tax for an income tax may not always produce sensible results since with a wealth tax there will be a tendency to go in for corporate shares with a low price/earnings ratio rather than those with a high price/earnings ratio (i.e., those with low current devidend but expected high returns in the future). With this kind of asset preference, companies venturing into areas like computers would have found it difficult to attract investors in the early sixties (Prest and Barr, 1979). In any case, to the extent the objective of earning additional income is to obtain larger consumption, a tax on wealth distorts the choice between present consumption and saving even though it might correct the disincentive effect of income tax on work effort.

The argument about inducement for optimum use of capital presupposes the existence of an efficient capital market. Few among the developing countries have truly free and well functioning capital markets. An annual wealth tax may thus act as a disadvantage to ordinary investors in the countries lacking well developed capital markets relative to more resourceful capital owners who can obtain expert advice and also manipulate the market at times.

Then there are the problems of valuation. Even those who agree that it is in principle attractive, shy away from the idea of a wealth tax because of insuperable valuation problems (Kay and King, 1980). It is found that

in countries where the wealth tax is in vogue, valuation is generally "indulgent" especially for owner-occupied houses and pension rights are not taxed in any event although they make a singificant difference to the pattern of wealth distribution in some of these countries, e.g., U.K. (Kay and King, 1980, Tait A.A., 1982).

After a careful examination of the pros and cons, the Taxation Review Committee of Australia (1975), known as the Asprey Committee, rejected the arguments advanced in support of the wealth tax. The Committee was particularly sceptical about the efficiency arguments as it felt that the wealth tax would tend to deter investment in new or risky enterprises. The Committee also apprehended that a wealth tax would adversely affect the desire to work and save.

c. Case for Taxing Transfers. The preceding discussion shows that there are weighty arguements against taxation of wealth and the case for an annual wealth tax in replacement of the income tax or even as a supplement to the income tax is not as obvious as is sometimes presumed. If, nevertheless, wealth taxation happens to be prevalent in several countries, in addition to the income tax, it is mainly because the income tax as it is practised suffers from some limitations and deficiencies which cannot be easily remedied, e.g., exclusion of certain categories of receipt like windfall gain, gifts and bequest from the tax base. While in principle, it should be possible to include gifts and bequests in the base of the income tax, with a progressive rate structure equity would demand provisions for averaging. Such provisions are never easy

to operate. While recommending the reform of the income tax towards an expenditure based tax the Meade Committee drew attention to the merit of including gifts in the tax base as the donor's expenditure (and alternatively, in the income of the donee) as that would enable the apparatus of a separate transfer tax to be dispensed with. The Committee however shied away from recommending the inclusion of gifts in the expenditure tax base as that would call for averaging and would also stand in the way of the application of the lifetime aggregation of transfers which they tought is a better way of tackling the growth of inequality.

Kay and King who were members of the Meade Committee later put forward a plea for integrating gifts and bequests under a lifetime expenditure tax (LET) system, which according to them would avoid many of the shortcomings of the income tax and, at the same time, make for administrative simplicity. According to them averaging under the LET would not be a serious problem as taxpayers would be expected to spread their gifts suitably over time according to their felt need to even out the tax liability. Rather, in their view, the inclusion of gifts and bequests in the donor's expenditure would expand the base of the LET and also help to bring owner-occupied houses under taxation effectively (Kay and King, 1980).

Many would be inclined to agree with Prest and Barr that the possibility of the expenditure tax being introduced seems remote. That apart, it is not easy to plan the timing of transfers. It is not possible to devise a reliable system of forecasting the dates of deaths of individuals; nor are most people likely to feel that they

can safely part with all their assets during their lifetime (Prest and Barr, 1979). Hence the need for averaging cannot possibly be altogether eliminated if gifts and bequests are included in the expenditure tax or, for that matter, the income tax base. Such integration also lacks the flexibility of separate taxation of gifts and bequests in the matter of defining the tax unit (such as the family) or taxing gifts differently from bequests. In any case, integration under the income tax system would militate against the generally accepted notion of income and would be difficult to push through the legislatures however persuasive the technical arguments may be. Integration of gifts and bequests under expenditure taxation also presents problems if the idea is to apply the ET only to a small fraction of the population (Prest and Barr, 1979).

The preceding discussion suggests that the income (or expenditure) tax base cannot conveniently comprise the receipt (or giving) of gifts and bequests, and capital gains too cannot be taxed in the same manner as other incomes. Some arrangement for taxing capital whether through an annual wealth tax or through some taxes on transfers, therefore, seems required. Under an income tax regime, the aim of such a tax should primarily be to tax gifts and bequests rather than accumulations out of saved income, for, as mentioned earlier, taxing one's own accumulations is hardly equitable. Since it is not possible to discriminate between inherited wealth and accumulations under a wealth tax the balance of considerations suggest that the tax on capital should be designed to tax transfers of wealth rather than ownership as such.

The case for taxing transfers rather than ownership of wealth is strongly supported also by the findings of research studies showing that inheritance is a potent cause of inequality in the distribution of wealth and that there is a highly significant correlation between dying rich and having had a rich father (Harbury and MacMohan 1973; Harbury and Hitchens, 1976). There is reason to think that even these studies understate the role of inheritance in perpetuating inequalities as they take no account of the gifts received by the sons from rich fathers (and trusts set up by the latter) in their lifetime not to mention the advantage of better upbringing which wealthy families can afford (Sandford, et al 1973).

A tax on transfers, particularly bequests, may also have less adverse effects on growth than the wealth tax. While there is no conclusive evidence to indicate whether death duties have any effect on private savings, persons who have accumulated large fortunes are not always keen to leave a large estate to their children (Sandford et al, 1973). Assuming, however, that the desire to bequeath is a determinant of saving the adverse effect of a transfer tax is compensated partly by the stimulus for work which a reduction in inherited wealth creates among the children of wealthy parents.

The discussion so far establishes the case for taxing transfers and moving away from taxation of wealth on a regular basis. However, the annual wealth tax has certain merits which cannot be entirely ignored. When accumulations take place out of incomes not subject to tax or by taking advantage of exemptions granted from income

tax, a wealth tax serves to correct the resulting adverse effects on equity and the setback caused thereby to the effort to check inequalities. A tax on net wealth also helps to neutralise the advantage gained by unrealized accretion to capital values to wealth owners. As the tax on capital gains is levied on realization only, postponement of realization helps to postpone the tax liability. A tax on wealth in such a system provides an instrument of taxing capital gains as they accrue. Finally, an annual wealth tax affords some scope for flexibility in the policy on capital taxation (governments of varying convictions may have different approaches to the question). By requiring taxpayers to submit regular account of wealth, the wealth tax provides a helpful instrument of control in the matter of enforcement of taxes like capital gains tax, expenditure tax or even the transfer taxes (Meade Report, p.p. 352-53). Adjustment for inflation is also simpler under the wealth tax than under transfer taxes. Moreover, an annual wealth tax may be useful also to compensate for the leakages in the transfer taxes like the estate duty occurring through avoidance and evasion. There is thus nothing wrong in having an annual wealth tax in addition to the transfer taxes but it needs to be reiterated that the rates of the wealth tax should be kept low especially when the tax operates along with the income tax and taxes on transfer of capital. Even under an expenditure tax regime where the wealth tax has a more important role as an anti-concentration measure the rates of wealth tax should not be pitched high as that goes against the philosophy of taxing only what is taken out of the "pool". The threshold level at which an annual wealth tax ought to be fixed, however, depends on the weights attached by the community to its social and economic objectives which is essentially a matter for political judgement.

d. Taxation of capital gains: A related question arising in the context of capital taxation is whether there is any rationale for taxing capital gains when wealth is taxed annually on its market value since such a tax on wealth also falls on the unrealised accretions to wealth occurring through appreciation in value. It may therefore be asked whether taxation of wealth as well as realised capital gains does not involve double taxation.

According to one view, capital gains when realised, but not before, are a form of income. They can be used either for consumption or for reinvestment. Hence there is no more reason in principle to exempt capital gains from tax than there is to abolish the income tax (Sandford, C.T., Willis, J.R.M., and Ironside, D.J., 1974). Another view is that, ideally, capital gains should be taxed annually on accretion basis and taxation on realised gains confers an advantage to the wealth owners because of the postponement. The annual tax serves to rectify this deficiency to some extent, depending upon the relative rates of tax.

There is thus no strong reason for exempting capital gains completely from taxation even where there is an annual wealth tax. However, it cannot be denied that the wealth tax serves to some extent as a partial substitute for the capital gains tax and, therefore, the rate of capital gains tax, which might be considered appropriate without an annual wealth tax should be

reduced with the introduction of the latter. What would be the proper rate for taxing capital gains is again a matter for political judgment (Sandford et al, 1974).

In any case, if the tax on capital gains is considered desirable it should be co-ordinated with the transfer taxes in such a manner that the heirs of decedents or recipients of figts are not encumbered with an excessively heavy burden of taxes and the behaviour of savers and investors is not affected adversely. The need for some coordination arises from the fact that there are alternative ways of taxing capital gains accrued on assets figuring in a transfer or bequest with varying impact on equity and behaviour of savers and investors.

The possible ways of treating the accrued but unrealised gains on assets passing on death are: (i) to presume realisation of gains at death and tax them accordingly, (ii) to recognise the gains but to defer taxation until they are realised by the legatees and (iii) to exempt them altogether by permitting the value taken for estate duties to be treated as the cost basis for computing the gain from any transfer made by the legatees. The first method is followed in some countries (e.g., Spain). In UK too capital gains tax was charged on the basis of constructive realisation at death for some time but it was given up in 1971. The commonly followed method is the second one, viz., granting postponement till realisation but computing the gain on the cost basis of the original acquirer of the asset, i.e., by permitting the cost-basis to be carried over. The third method was followed in the US, but the practice has undergone some changes recently (OECD, 1979, Byrne, W.J., 1980).

The system of permitting step-up of basis, i.e., exempting the unrealised gains on assets passing on death invited strong criticism on the ground that it resulted in inducing people to retain their holdings till death. On grounds of both equity as well as wholesome economic effects, presumptive realisation at death has been advocated by many as the most desirable solution (David, Martin, 1968). Elimination of taxation on presumptive realisation in UK has revoked criticism and has been described as a retrograde step (Prest and Barr, 1979). However, taxation of capital gains at death (and similarly on gifts) on a presumptive basis encounters difficulties as the UK experience shows. The financial strain on the legatees likely to arise from such taxation along with the estate and gift tax cannot be overlooked. The system of postponing taxation till realisation, that is, allowing the carry-over of the previous basis, seems to be the best alternative among the three.

The current practice in India is to compute the capital gains from inherited assets on the basis of the cost to the previous owner and calls for no change. To provide relief where an inherited asset on which estate duty is payable is sold away within two years following death and capital gain is charged on the gains arising from the transfer, some reduction is allowed in estate duty (Section 50B of the ED Act). This provision serves to mitigate hardship but opens up some scope for avoidance and needs to be tightened up a little, as indicated in a subsequent paragraph.

The total burden of taxation resulting from the operation of the various capital taxes is illustrated below with a hypothetical example. Assuming a capital appreciation rate of 10 per cent per annum, the value of a house property acquired say in 1973 for Rs 10 lakh would go up to Rs 26 lakh approximately in 1983. In the even of death of the owner of such a property in 1983 the capital taxes payable over the period including estate duty and capital gains tax (if the property is sold within two years after the death of the owner for, say, Rs 28 lakh) would work out as follows:

1.	Net wealth tax (There would be no increase in wealth tax due to appreciation in value because of the provision for freezing)		Rs 11,750 per annum
2.	Capital gains tax on Rs 18 lakh (after allowing relief admissible under section 80T of Income-tax Act)		Rs 8,30,790
3.	Estate Duty:		
	Gross duty	Rs 10,84,900	
	Less relief under section 50B of ED Act (Capital tax X Gross E D Payable / Sale proceedings)	3,21,930	
	Net ED Payable		762970
	Total transfer tax payable		1593760

It may be seen that roughly Rs 16 lakh would be payable in duty if the property is valued for purposes of ED at Rs 25,94,000 which works out to a little over 57 per cent. However, with the extension of the valuation rule 1BB of the wealth tax rules to one property for the ED the amount payable in ED should not exceed Rs 1,30,000 (after allowing relief under section 50B) which constitutes only about 5 per cent of the current value of the property. Together with capital gains tax, the incidence comes to about 34 per cent of the realised value of the peoperty.[1/]

While the outcome of the taxes and the valuation rule may not be regarded as unfair or too harsh, the illustration serves to reveal the impact of inflation on estate duty. In the absence of any moderation in valuation what adds to the total burden of the taxes is inflation rather than the multiplicity of taxes. However, in order to avoid causing any distortion in the investment pattern it would be desirable to mitigate the effects of inflation through moderation in rates rather than free ing the value of any particular asset. There may be some justification for granting a concession for the house of the family in estate duty. But the issue needs to be examined in the wider context of the treatment of transfers within the family. This is gone into in the next chapter.

1/ No account is taken of the local property taxes as these are essentially in the nature of a cost of municipal services. Taxes payable in stamp duty for obtaining letter of representation or probate are also left out as relief for these taxes is allowed in full against ED.

To sum up, considerations of equity and reduction of inequalities call for taxation of capital. However, taxes on transfer of capital are more suited for achieving these objectives. An annual wealth tax is useful as an instrument of control and as a device for correcting some of the deficiencies of the income tax and transfer taxes like the tax on realised capital gains. But these considerations argue for a mild annual tax on wealth, the accent being mainly on transfer taxes.

CHAPTER 6

STRUCTURE OF TRANSFER TAXES

Granting that transfer of wealth ought to be taxed especially when there is passing on death, it needs to be considered what should be the structure of such taxation. The important questions which arise for consideration are: (a) Should bequests alone or lifetime gifts too be taxed? If gifts are taxed, what should be inter-relation between the two taxes? (b) Should transfers be taxed to donors/decedents or to donees/legatees? and (c) Should there be any concession in favour of spouses or minor children? Issues bearing on the structure of transfer taxes have been dealt with extensively in the literature. A brief survey is presented in the next few paragraphs.

a. Aggregation and cumulation of gifts and bequests.

It needs no argument to demonstrate that a tax on bequests cannot be effective unless there is a tax on lifetime gifts too. As is well known, the absence of any tax on gifts inter vivos had rendered the death duties in UK virtually to be "voluntary tax". The points to consider are, first, should gifts be taxed totally independently of bequests at different rates or should there be some integration of the two and, secondly, if the two are not to be fully integrated, should there be any cumulation of gifts for purposes of gift tax?

Ideally, under an estate type, that is, donor-based tax all gifts made during one's lifetime should be aggregated with bequests at the time of death. Similarly, the receipt of all gifts and bequests should be cumulated in the hands of the recipient where the transfers are taxed to the donee as otherwise the objective of progressive

taxation of transfers is defeated. This presumably is the aim underlying the Capital Transfer Tax (CTT)introduced in the UK in 1975 replacing the death duties.

However, a case can be made out for taxing gifts inter vivos at a lower rate in order to encourage quicker dispersion (Prest and Barr, 1979). But the gap between the two rates should not go beyond a certain limit. For, as the experience of UK prior to the introduction of the CTT shows,too liberal treatment of gifts when estates are subjected to tax at high rates,renders the tax on estates virtually nugatory. For the same reasons, the base of the two taxes should also be more or less uniform and the scheme of exemptions, exclusions etc. should not be widely divergent.

The CTT of UK provides for the cumulation of lifetime gifts with bequests. The rate of tax on a given amount of gift depends on the total amount given away earlier (including the CTT payable). The rate of tax is lower on the first £3,00,000 of inter vivos gifts than on transfers made within three years of death. Certain exemptions are however allowed (e.g., for small gifts, habitual expenditure out of income and the first £ 2,000 of transfers in any one year) apart from any initial exemption of transfers, (upto £ 25,000) cumulated over the donor's life. Transfers between spouses are also exempt.

In the USA too, since 1976 both lifetime and deathtime transfers are aggregated and subject to tax according to a unified rate schedule. The separate exemptions available under the two transfer taxes prevalent earlier

were replaced under the Tax Reform Act of 1976 by a unified credit which fully offset the tax liability until taxable transfers exceed a certain limit. As of 1981, this limit stood at $ 192,800. All "qualified transfers" to a surviving spouse are exempt and there is an annual exemption of $ 10,000 per donee apart from exemption of certain transfers in payment of tution and medical expenses of third parties.

The trend thus seems to be towards unification of estates and gifts taxes, subject to certain exemptions. Most of the other OECD countries levying death duties or similar transfer tax have gone in for unification either partial or full, the period of partial integration varying from 3 to 10 years. In countries where the two taxes are fully integrated there is a single code of law and generally, the same or nearly the same scales of rates apply to both lifetime transfers and transfers on death, irrespective of whether the tax is of the estate type or the inheritance type.

b. <u>Donor-based v. Donee-based transfer taxes</u>. An equally important issue arising in the context of transfer taxation centres around the question whether transfers should be taxed to the donor or the donee. Practices in this regard vary widely as do opinions. Broadly, donor-based taxes are preferred by Anglo-Saxon countries while the continental countries prefer the donee-based type. In the 19 countries covered in an OECD study, estate duty operates in 4, while 13 have

transfer taxes of the inheritance type and two have a mix of both (OECD, 1979).

As pointed out by Prest and Barr, if one were to judge by the impact on the incentives to work, invest and save, there is probably not much to choose between a donor-based tax like the estate duty and a donee-based levy like the inheritance tax (Prest and Barr, 1979). The main consideration which weighs in favour of the donee-based type taxes is equity. A tax on an inheritance is preferable on equity grounds as it accords more with the ability to pay criterion and it can be tailored more easily to the circumstances of the recipients and their relationship with the donor. Also, a progressive tax on capital transfers can be more effective in encouraging wider dispersion of inherited wealth if the tax is levied at progressive rates with reference to the aggregate capital receipts of the donors that is, in the form of an accessions tax (AT) rather than as a duty on estates.

However, the estate tax too has its merits and the AT, its drawbacks. Apart from its administrative simplicity and better revenue yielding capacity, the ED has a greater edge as an instrument of reduction of inequalities in that it enables a larger slice to be transferred to the State out of large estates than is possible with an AT. Unless there is sharp differentiation in the rates to discourage transfer within the family, the AT usually serves to induce wider dispersion within the family or among persons close to the family.

Even from the equity angle, in certain situations the AT may produce undesirable effects. For instance, under an AT an estate left to only widow may suffer taxation at a higher rate than one passed on to a number of grandchildren. If revenue is to be protected, the tax rate may have to be higher for capital sum of a given size under an AT than under the ED. The result may be that a widow inheriting her husband's estate would be required to pay a higher amount of tax. It seems that there is an inverse relationship between the size of estates and the number of beneficiaries (a larger percentage of small fortune owners leave their estates wholly to their surviving spouse). If this be true, then an AT would lead to a shift in the tax burden from upper to the lower brackets of wealth owners (Prest and Barr, 1979). Even with a revision in the rate structure, with an AT, the possibility of small bequests suffering a higher burden of taxation cannot be ruled out.

For an AT to be really equitable, the tax ought to be levied with reference to the total wealth owned by each beneficiary rather than on the basis of the wealth received through gifts or bequests on a given occasion. Administrative problems likely to be encountered rule out the consideration of an AT of such variety.

As for the claim that a donee-based tax facilitates variation in rates, exemptions and reliefs to take account of the circumstance of the donees and their relationship with donors, provisions for special treatment of spouses or minor children can be built into an estate duty too, though it must be conceded that such variations are easier to

operate through an AT. However, as noted earlier, the equity case for the AT is not as overwhelming as might seem at a first glance (OECD, 1979).

Even assuming that an AT provides a greater incentives for wider dispersion of inherited wealth, both the AT and the ED (including the CTT of the UK type) suffer from a serious deficiency from the equity angle in that they make no distinction in casting the burden of the tax between short and long periods of holding of wealth. As a result, one who owns a given amount of wealth for five years is taxed at the same rate as one who holds it for say 50 years. This also makes it possible to avoid taxation by reducing the frequency of formal transfers of family wealth such as by setting up trusts. This is believed to be responsible for the use of trusts to hold wealth for several beneficiaries and for generation-skipping transfers from a grandfather to his grandson or great-grandson rather than to his son (Meade Report, Ch.15).

Concerned at the seriousness of the inequity created by the deficiency mentioned above, the Meade Committee, while expressing its opinion in favour of the accessions type transfer tax, suggested the introduction of a progressive annual wealth accessions tax (PAWAT) to take account of likely differences in the period of holding of the transferred wealth. Under the tax system envisaged by the Committee a donee would pay tax on any gift received at a progressive rate applicable to the aggregate value of gifts received earlier (minus any tax paid already) and the tax would depend not only

on the cumulated value of gifts but also upon his age, the tax rate being higher, the younger the donee.

On receipt of a gift the donee would pay as transfer tax an amount which corresponds to a lumpsum advance payment to cover an annual wealth tax for a given future period estimated on the expected period of life (upto his 85th birthday). There would be a rate schedule for an annual wealth tax. First, the tax amount payable under this schedule would be worked out for the gift in question aggregated with the earlier gifts with set-off for taxes already paid. The PAWAT would be determined by multiplying the tax so worked out with an annuity multiplier indicating the present value of an annuity of Rs 1 for the years from the year of gift to his 85th birthday. The gift would thus be "franked" for an annual wealth tax for the period from the year of gift to the 85th birthday of the donee. If he makes a gift of the same property before attaining the age of 85, the gift will be "defranked" and he will get a refund for the annual wealth tax which was paid by him in advance for the unexpired period upto his 85th birthday. The donee however would pay the PAWAT in the same manner as described earlier. There would ordinarily be a net tax on the gift unless the donee happens to be older than the donor, or the rate of tax applicable to the donee is much lower than that at which the gift was charged in the hands of the donor.

The calculations would be simpler if there was no progressivity in the tax rates. Hence the Meade Committee suggested as an alternative, a linear annual wealth

accessions tax (LAWAT). Yet another variant is an age gap annual wealth accessions tax (AWAT) in which the net tax would be assessed simply on the basis of the difference between the age of the donor and the donee.

The idea of varying the transfer tax with reference to the relative ages is not entirely new. It was first proposed by Vickrey in the form of a bequeathing power succession tax (Vickrey, W., 1947) but the operation of any such scheme is much too complex to be considered feasible. As noted by the Meade Committee, apart from administrative problems, the PAWAT would run into problems unless the tax rates and prices remain stable, and the annuity tables too do not undergo much change. Moreover, while taking care of one source of inequity, a tax of the kind proposed by Vickrey, or more recently by the Meade Committee, may involve a sacrifice of some other equity aims, e.g., graduating the tax by relationships (Shoup, Carl, 1966, Ch.VIII).

It has therefore to be concluded that however attractive an AT may appear to be from the equity angle, it is much more difficult to administer than a donor-based tax. The difficulties are likely to be even more formidable in India in view of the peculiar systems of succession under the Mitakshara School of Hindu Law which governs large sections of a major community in the country, namely, the Hindus. For, under the Mitakshara law a male child acquires an interest in the joint family property right from birth. A female child does not acquire a coparcenary interest as such but is entitled to some allowance if a partition takes place.

If the transfer tax is levied in the form of an AT, the liability to tax should arise as soon as one is born in a Mitakshara family. But the share of the coparcener is liable to change with births and deaths in the family. Therefore, under an AT, equity would require a revision in the tax liability everytime if there is an incident of birth or death. Clearly, this is an impossible proposition.

Ultimately the choice between an estate duty and an AT also depends on one's view of the goals of society. For the two forms of duty imply a different social and political philosophy. Estate duty serves to reduce inequality by appropriating private assets to the State and since it applies on the entire estate, it has a greater potential for reducing inequalities. An AT also serves to transfer private assets to the State partly in the same way and also by encouraging the property owners to make gifts and bequests to those who have received little or nothing by way of previous accessions (Sandford, C.T., et al. 1975) but the range of such transfers is unlikely to go beyond the family. In the context of the acute inequalities prevalent in India, a switch to an AT would undermine whatever influence the existing transfer tax has had so far in reducing the disparities in wealth ownership. It is to be noted that in spite of an intensive debate and a strong body of expert opinion in favour of an AT, Britain reformed its death duties by introducing a donor-based CTT integrating lifetime gifts with bequests. However, it should also be noted that in recent years some among the OECD countries have moved over to donee-based variety of the transfer tax

(e.g. Ireland introduced a capital acquisition tax, abolishing the estate tax in 1975).

So far as India is concerned, administrative considerations rule out the introduction of any donee-based tax in place of the ED. Even if an AT is left out of consideration because of complexities and attention is confined to an inheritance type transfer tax, the number of taxpayers under a donee based tax would be much larger than under the ED. Many of the recipients of gifts and estates will presumably be persons of relatively small means, unless the threshold level is raised appreciably. A high threshold for an inheritance tax would on the other hand affect its redistributive potency.

It is possible to introduce the donee-based principle into the existing ED if only the number of beneficiaries and their shares are known and in most ED cases this information should not be difficult to obtain but, as noted earlier, equity cannot be served unless reference is made also to the existing wealth status of the donees and the total amount of gifts and bequests received by each legatee of a decedent's estate.

The upshot of the discussions presented above is that, for reducing the inequalities, transfer taxes are more effective than an annual wealth tax. A wealth tax may be levied to supplement the income tax to make up its deficiencies in the matter of taxing capital gain and the failure of the income base to reflect taxable capacity faithfully and also to help cross-check the data on income (or expenditure where the tax is sought to be levied on an expenditure base), but such a tax should be mild. Among

the transfer taxes, administrative problems outweigh the other merits of AT. Even from the equity angle, the case for an AT is not all that clear. There is thus no persuasive reason for replacing the ED in India by an AT especially since the ED has been in operation for nearly 30 years now and interpretation of many of the provisions is well settled through judicial rulings. Attention therefore needs to be paid to ways in which the operation of the ED can be made more effective and its inequalities and anomalies removed.

As suggested in Part I of this study, the most important structural reform needed in the ED as it is operating now is to provide for cumulation of lifetime gifts with bequests. In order to keep the task manageable, the cumulation may be limited to gifts made over a period of ten years or at least 7 years before death. As will be argued presently, this will help remove some of the anomalies resulting from the attempt to prevent avoidance through inter vivos transfer and simplify the law. There are however a few more issues relating to the structural reform of the tax. These are given below.

c. <u>Tax unit and threshold level</u>. The equity as well as the efficacy of any form of progressive taxation depends crucially on the choice of the tax unit because of the facility of avoidance afforded by transfers within the family. In the case of a transfer tax, the treatment of transfers among family members, particularly between spouses, poses a troublesome problem as a satisfactory and at the same time administratively feasible solution is not easy to formulate.

In countries where the inheritance type tax is in vogue, a common practice has been to prescribe different scales of tax rates for different degrees of relationship. Transfers between spouses are usually given preferential treatment. With estate taxes, while no concession is made on grounds of relationship, the normal practice is to provide relief for property passing to a surviving spouse Favourable treatment is also accorded to lifetime transfers between spouses (OECD, 1979). In UK , inter-spousal transfers are totally exempt from the CTT. In USA too, under the integrated gift and estate tax, transfers between spouses are exempt. In India there is no special concession for estate passing to a surviving spouse. The normal quick succession relief is available where the surviving spouse dies within a specified period of the death of the pre-deceased spouse. The relief varies from 50 to 10 per cent of the duty depending on the gap between the two deaths. No relief is given if the second death occurs after five years of the first, vide section 31 of the ED Act. Deaths occurring within three months are treated as one. Exemption is available only for the interest of a Hindu widow devolving upon reversioners if the widow dies within seven years of the husband's death (section 32). While it is difficult to lay down any universally applicable rule in this regard, what should be the appropriate treatment of inter-spousal and intra-family transfers depends essentially on the aims sought to be achieved through taxation of transfers and the weights attached to each.

As noted by Shoup in his celebrated study of estate and gift taxes in USA (Shoup, Carl, 1966), three objectives usually figure in the discussions of death duties and gift taxes: (i) taxation of windfalls; (2) taxation of property

once a generation and (3) taxation to reduce concentration. Assuming that all the three objectives are sought to be achieved with varying emphasis, transfers between spouses or close relatives ought to be ignored or taxed lightly as thev cannot be said to be totally unexpected. Additionally, transfers between spouses should be ignored as they amount to transfer within the same generation. If however, reducing concentration is the aim, transfers of large estates should be taxed heavily in all situations. The three-aim view also helps to find answers to related questions regarding treatment of transfer to children and also in the choice between an estate tax (E), inheritance tax (I) and an accessions tax (A), as demonstrated by Shoup in the table reproduced below.

A surviving spouse is generally given relief also on compassionate grounds apart from the fact that transfers between spouses cannot be regarded as windfalls and the inter-generation devolution argument also does not apply. There are other arguments for ignoring transfers between spouses such as the difficulty of monitoring them. Attempts to monitor such transfers may also be objectionable. Thus except where the estate passing on the death is large, the passing of wealth to a surviving spouse merits exemption. The practice followed under the British CTT thus seems to be well founded in equity. The position in Indian ED does not seem to be very equitable and requires reform.

There may be problems in ignoring transfers between spouses within an accessions tax though practical considerations rule out monitoring all such transfers. On the other hand, if transfers of wealth between spouses are to be

TABLE 33

Influence of Basic Aims on Answers to Selected Technical Questions in Death and Gift Taxation

Item	Basic aim		
	Taxing property once a generation	Anti-concentration	Windfall taxation
1. Transfer outright:			
a. To spouse	Exempt	tax	exempt
b. To children	tax	tax	exempt
c. To grandchildren	Tax doubly	exempt	tax
2. Upon expiration of each life interest in trust*:			
a. Wife life tenant, children remaindermen	Exempt	tax	exempt
b. Children life tenants, grandchildren remaindermen	tax	exempt	tax
c. Children, grandchildren life tenants; great grand-children remaindermen	tax	exempt	tax once or twice
3. Basis of rate progression	none	heir's wealth	relationship and "age" of wealth (Rignano)
4. Order of preference: accessions, estate, inheritance tax	E, A, I	A, I, E	I, A, E

* Assuming that the transfer to the trust has been taxed

Source: Carl S. Shoup, (1966) Federal Estate and Gift Taxes, Studies of Government Finance, The Brookings Institition. (May)

ignored, the couple has to be treated as a single unit for taxation. Such a system runs into serious problems if the tax is to be based on the age of the donor and the donee as under the PAWAT proposed by the Meade Committee.

Where bequests are integrated with lifetime gifts, some of the problems mentioned by the Meade Committee in the context of the PAWAT are likely to be encountered under the estates tax also as, for example, the problem of monitoring small gifts and adjustments required for inflation. If however, as proposed in this study, lifetime gifts over a period of only 7 to 10 years before death are aggregated with bequests, exemption upto a limit of say Rs 3 lakh may be allowed for estates (including cumulated gifts) passing between spouses keeping in view the anti-concentration aim. Transfers between spouses (excluding amounts transferred by one to the other spouse for normal family expenditures) should however be aggregated over the lifetime of the spouses until separation or death of one as provided now. In India, lifetime gifts to a spouse are aggregated for the GT since there is a lifetime exemption of upto Rs 50,000. There should, therefore, be no difficulty in operating a cumulated exemption of gifts and bequests to a spouse of upto a specified ceiling.

The need for a ceiling on the exemption of inter-spousal transfers for estate taxation in India is reinforced by the fact that home properties are sometimes acquired by the husband in the name of the wife, i.e., in "benami". Although the inclusion of a benami property in the estate of the beneficial owner has been upheld by the Supreme Court (in the case of CED v. Aloks Mitra), it is not easy for

the revenue authorities to prove "benami", as the onus lies on them, where the property is ostensibly owned by someone other than the deceased. The problem is totally avoided if the couple is taken as a unit and all inter-spousal transfers are ignored for both ED and GT. That would also meet the first two of the three aims, but would militate against the aim of anti-concentration, although it might be regarded as a good alternative. With such a system of transfer tax, however, the couple should be regarded as one unit for purposes of wealth tax.

In some countries special relief is granted from transfer taxes for a matrimonial home. This is understandable since in the absence of such relief the survivor would often find it difficult or impossible to pay the tax out of his or her other resources, that is, without selling away the residential house. This presumably is the principal consideration underlying the relief granted in ED in India for one house upto a value of Rs 1 lakh and also the recently introduced provision for lenient valuation of one residential house (by applying rule 18B of WT Rules).

As the OECD study on capital taxation points out, it would be fairer if relief for a surviving spouse is not tied to the possession of a particular kind of estate. The 1976 amendment to the Australian estate tax recognised this. Hence, if total exemption for inter-spousal transfers is found unacceptable, it would be advisable to replace the exemption now available for one house by an overall ceiling of Rs 5 lakh. The idea of exempting one residential house irrespective of its value violates both horizontal and vertical equity. However, if valuation at market rates where

property prices are soaring is thought to be a source of hardship and harassment, the exemption for a residential house should be restricted to a specified covered area - "living space" - and not just in terms of one residential house.

Equity considerations argue for some concession for minor children. The exemption limit should partly take care of the problem. Some additional allowance for each minor child may be granted towards maintenance. The allowance may be fixed at a reasonable rate per year (say Rs 3000 per child) to take account of maintenance upto the age of maturity, not exceeding Rs 50,000 per child.

With an overall ceiling of Rs 3 lakh for inter-spousal transfer and allowance for minor children, the threshold level for the ED (cumulated with gifts over 7 to 10 years before death) may be fixed at a moderate level of Rs 1 lakh or so. Considering that the exemption level was raised from Rs 50,000 to Rs 1.5 lakh only recently to take account of inflation and that the level of Rs 50,000 was fixed as far back as 1960, there is no need to disturb the recently revised limit.

The threshold for the gift tax should be kept at the same level as for estate taxation where the two are fully unified. Where, however, there is only partial integration as is proposed in this study, the exemption limit for gift tax has to be kept at a lower figure than for the ED. The present exemption limit of Rs 5,000, over and above the exemptions given for lifetime gifts to spouse, marriage of dependent relations and for gift of insurance or annuities of Rs 10,000 for each is not very unreasonable.

The cumulation of gifts made in a year with those made in the preceding 4 years also serves as a check on avoidance and may, therefore, continue. The exemptions granted for specified assets however seem to be a little too liberal (as for example for a gift of Capital Investment Bond of upto Rs 10 lakh and gifts of foreign currency or foreign exchange remitted by a non-resident Indian citizen to a resident in India and the gifts of specified securities).

The exemption limit, it is often suggested, should be indexed to mitigate the impact of what is described as "the inflation tax". While there is some merit in this suggestion, automatic indexation has its problems. First of all, what should be the appropriate price index, is not easy to decide. Where valuation rules tend to reduce the value of assets included in the tax base below their market level, the plea for indexation loses its force. However, in equity, both the threshold level and the exemption should be reviewed periodically to take account of inflation while the valuations should be made at prevailing market rates.

Restructuring of the estate and gift taxes on the lines suggested above should help to improve the equity of the system and orient them more clearly towards the aims sought to be achieved through taxation of capital transfers. Measures are needed in other directions too to remove hardship and anomalies and facilitate the administration of the transfer taxes.

CHAPTER 8

POSSIBLE LINES OF REFORM

Measures for Improving Elasticity

Notwithstanding the provisions for allowances and deductions, the base of the levy under the ED Act 1953 is prima facie fairly comprehensive in that it embraces properties and interests of all kinds passing on death unless provided otherwise. The Act also contains several anti-avoidance provisions authorising the inclusion of properties and interest of which the title did not belong to the deceased at the time of death. However, Part I of the study shows that the yield of the duty has been low mainly because of lack of growth in the base with growth of capital formation and property prices. The possible reasons for the poor elasticity of the base principally are:

(a) Avoidance and evasion.

(b) Exclusions, exemptions, rebate, and reliefs.

(c) Under-valuation of assets both moveable and immovable relatively to market values.

(d) Deductions admissible in the computation of the PV, and

(e) Deficiencies in administration.

The manner in which these are affecting the base and how they can be got over or the damage caused by them can be minimised is examined below.

a. Avoidance and evasion. As in income tax and wealth tax a simple way of avoiding or reducing the liability of a progressive estate tax is to split the base. A study carried out by the Income Tax Department revealed that while the assets of large industrial houses have recorded growth rates

ranging from 55 to 190 per cent over a period of five years (1972-77) in most cases the wealth of industrialists controlling these houses has declined as compared to their wealth in 1957-58 (Public Accounts Committee, 101st Report, 1982). The techniques of avoidance identified in the study are:

1. Creation of private trusts and transfer of assets to trusts;
2. Creation of investment companies and transfer of assets to these companies; and
3. Transfer of assets to Hindu Undivided Family (HUF).

In the case of one family alone the number of private trusts has increased from 400 to 1,600 since 1972, the beneficiaries being only 25 members of the family. The distribution of beneficiaries and trustees has been so arranged that anti-avoidance provisions of the income tax (and wealth tax) are rendered ineffectual.

Presumably, the devices described above are used for avoiding the ED as well. Transfers through gifts constitute another convenient way of avoiding ED. That is why, as noted already, estate taxation has to be complemented with a tax on gifts. Even so, where the exemption and the rates differ and the arrangement for cumulation of gifts is either absent or deficient, inter vivos gifts provide a broad avenue for avoidance.

That lifetime gifting is a popular way of reducing the ED is evidenced by the fact that the number of GT cases is in the region of 70,000 to 80,000 every year as against 12,000 to 15,000 cases suffering ED annually

(table 23 and table 10 of Part I) and that nearly 99 per cent of the GT cases fall within the range of less than Rs 1 lakh.

Inter-vivos gifts are however taxable and the exemption limit (Rs 5000) is quite low compared to that prescribed for the ED, even if account is taken of the exemption of inter-spousal gifts of upto Rs 50,000 in a lifetime. In order to reduce the scope for avoidance of spread-over in different years, gifts made over four years are aggregated with those made in a given year. Ineffectual gifts and gifts made within a specified period of death and gifts with reservation are deemed to pass on death in certain circumstances. The policies which have evolved over the years towards the tax treatment of gifts are anomelous in several respects and need rationalisation.

The ED Act had come into operation in India before the introduction of the GT. As a measure of protection against avoidance through transfers the framers of the Indian law had put in a few provisions to bring gifts made within two years before death (six months for gifts to charities) within the ED base and also gifts made beyond two years until the transferor divests himself of ownership and possession without any reservation. A particularly potent provision in the ED Act was section 10 which stipulated that gifts, whenever made, would be deemed to pass on death if any benefit was reserved by the donor in any form or unless the donor is entirely excluded from the possession and enjoyment of the property gifted. Though based on a similar provision in the prevailing UK death duties, the potency of the provision was undermined through judicial rulings and legislation. By an amendment

in the law it was made clear that gifts of a house property made to close relatives (of a defined category) would not be deemed to pass on death simply because the deceased continued to reside there. Another amendment took out of the purview all gifts made beyond five years before death if the gift happened to be liable to gift tax. How the power of section 10 has been undermined over the years is described in more detail in Appendix II.1.

Exclusion of gifts suffering GT from the ED base in a scheme where the two are not unified is understandable. But the logic of retaining the provision of section 10 for gifts made within five years even when subjected to GT is difficult to see since the scheme of estate taxation as it operates now does not envisage the inclusion of gifts in bequests other than gifts made within two years before death. Section 10 thus now applies to a very narrow category of transfers, <u>viz</u>., those falling beyond two years but not more than five years before death and even within this narrow category it does not apply to transfer of house property to close relatives even if the deceased continued to reside in it during the intervening three years.

Evidently, the anomaly is the result of piece-meal attempts to co-ordinate the operation of the ED with the GT. Under a unified scheme, gifts made within the critical period should be aggregated with bequests with set-off for the GT paid while genuine gifts made beyond the critical period should be excluded. The tests of genuinenessas laid down in section 10 (and also the other provisions like section 12 which deal with property settled

with reservation) may be retained and the total exemption now available under section 33(1)(o) of ED Act for taxable gifts made beyond five years before death should be withdrawn. The provisions of section 10 should also be tightened to remove the weaknesses discussed in Appendix II.1. It may be added however that provisions like section 10 and section 12 would not be required under a completely unified system of estate and gift taxation. So long as unification remains partial there is no alternative but to retain them. The rates of the GT should also be such as to induce lifetime transfers but without providing an avenue for avoiding the ED altogether.

Under the existing system the effective rates of gift taxes at all slabs upto Rs.20 lakh are higher than the ED rates even though the marginal rate above Rs. 20 lakh is higher by 10 percentage points in the case of ED. This is probably because of lower exemption limit and the higher rates on the initial slabs under the Gift Tax Act (GT Act). Nevertheless, it is possible for a wealthy person to split up his estate by carefully planned spread over of gifts in his lifetime and take advantage of the various exemption provisions such as spouse gifts, marriage gifts, gift of insurance policies, etc., and thereby reduce the property owned by him at the time of death to a low level, if not below the exemption limit. This presumably explains why gifts of less than Rs 1 lakh account for over 99 per cent nearly of the gifts coming under the GT. To reduce the scope for such avoidance without discouraging giving in one's life-time the GT rates in the initial slabs may be stepped up from 5 and 10 per cent to 10 and 15 per cent and correspondingly in the upper slabs as suggested in Part I.

A well-known medium for avoidance of transfer taxes is the institution of "Trusts", and as noted already these have been used in India too to defeat direct taxation. Trusts providing benefit to specified persons for life and thereafter to their children were a popular vehicle in the USA for skipping generations while transferring property without paying any estate or gift tax. In India interests ceasing on death are deemed to pass and thus generation-skipping is not so simple under the Indian ED Act. However, no assessment on account of cessor of interest can be made in the event of the death of a beneficiary in a discretionary trust. Fairly stringent measures have been taken in the income tax and wealth tax laws to neutralise the advantage from setting up discretionary trusts. As explained in Appendix II.2 where the matter has been examined in further detail, some advantage can still be derived from these trusts. It is therefore desirable to incorporate measures in the ED Act too to deal with such trusts. Possible lines of reform in this regard are:

(i) Taxing a slice of the trust properties in proportion to that of the benefits actually received by deceased beneficiary in the last three years of death. But as in the case of transfers to controlled companies (discussed below) the determination of benefits actually received may present acute difficulties. Hence the alternatives mentioned under (ii) and (iii) below might be more feasible.

(ii) Taxing the properties of a discretionary trust at the rate of 25 per cent every 10 years, as under the British CTT.

(iii) Yet another and simple alternative would be to impute equal share to all beneficiaries in the assets of the trust.

Instances of evasion of ED coming to light are surprisingly few. It is not easy to conceal assets like house or equities and bank deposits especially since succession to these assets often requires judicial authorisation. It is only assets like cash, jewellery and household assets and to some extent assets of business which are amenable to concealment. Although not many concrete cases of evasion have come to light, it would be unrealistic to suppose that evasion is not practised in the ED at all. Hence the provisions for countering evasion in the ED Act need to be strengthened. Measures which help this objective are:

(i) The permissible period for reopening an ED case may be extended in the case of concealment from the existing 3 years to 8 years where the quantum of concealed wealth exceeds a specified limit, say, Rs 1,00,000.

(ii) The provisions for penalty should be tightened up to cast a joint and several liability to make a true statement of all dutiable assets left by a decedent. The account should either be verified by all major legatees or account should be submitted separately by each.

(iii) There is no provision for prosecution in the ED Act as such for any offence. Proceedings for prosecution can, of course, be initiated under the Indian Penal Code for false affidavit while filing the statement of account for ED assessment. That however

is cumbersome. Provisions similar to those in the Income-tax Act should be incorporated authorising prosecution for concealment and other serious offences.

(iv) Claim to title to property, standing in the name of a benamidar, by legatees of a deceased person on grounds of succession, should be forbidden unless the property is included in the ED account.

This will help to counter the practice of keeping properties in Benami. Such a provision already exists to counter evasion of income tax and wealth tax and should be extended to cover the transfer taxes as well.

b. Exclusions, exemptions, rebates and reliefs. Properties of certain categories are totally excluded from PV of a taxable estate while some are included for rate purposes. Each of these items constitutes a source of leakage of duty. Leakage of the base is facilitated particularly by items which do not figure in the tax base at all. The principal sources of leakage are: (i) "separate" estate provision under section 34(3) of the ED Act; (ii) exclusion of agricultural land; (iii) exemption of coparcenary interest in HUF property and (iv) immovable property situated outside India and moveable settled property in certain cases.

(i) Separate estate. Under the provisions of section 34(3) of the ED Act, property passing or deemed to pass on the death of the deceased in which he had never any interest is regarded as an estate by itself. Such

estate is not aggregated with other properties but ED is leviable on such property separately at the rate applicable to the principal value thereof. The courts have interpreted the section to mean that each such estate is to be assessed separately and if more than one passes on the death of the deceased no aggregation is permissible *inter se*. The result is that, if the value of any such estate happens to be equal to or below the exemption limit, no duty is leviable. Common examples of such estates are (a) monies payable under policies issued under the Married Women's Property Act; (b)annuity payable, after the death of the deceased, to family members or other relatives by the insurance companies against payment of either lumpsum or periodical premiums paid by the deceased while alive, (c) monies payable under an accident insurance policy/policies taken by the employer on the life of the deceased employee where the employee had no power of nomination to, or disposal over, policy monies; (d) ex-gratia payment receivable under the Deposit Linked Insurance Scheme in accordance with Rule 33A of the General Provident Fund (Central Services) Rules, etc.

With the growth of general consciousness amongst the people of the need for saving and making provision for employees/dependants the number of such estates would presumably have multiplied. With the recent increase in the exemption limit the chances are that most such estates, taxable in principle, will go out of the tax net. Not only are such estates excluded from the main corpus of the dutiable PV, they adversely affect it indirectly in the sense that, but for the creation of such

estates, monies spent for the same, unless spent during lifetime, would have appeared in the form of property passing under section 5 and/or 6. In the case of items (1) and (2) enumerated above, the courts have also taken the view that the periodic payments of premium by the deceased do not constitute gifts for purposes of Gifts Tax Act. With the partial unification of estates and gifts over 7 to 10 years, and provision for exemption of inter-spousal transfers of upto Rs 3 lakh, the "separate" estate provision should be done away with.

(ii) Exclusion of agricultural land. Under the Constitution, no estate duty can be levied on agricultural land under a Central Act unless authorised by the States. The legislatures of all States except Jammu & Kashmir and West Bengal had consented to the extension of the ED to agricultural land. Hence agricultural land situated in the States listed in the First Schedule to the ED Act were included in the PV for purposes of the ED. Some concession in duty was provided for agricultural land included in estates of less than Rs 2 lakh. In the Budget Speech for 1983-84, the Union Finance Minister has announced the intention of excluding agricultural lands from the purview of the ED mainly on the ground that valuation of agricultural land leads to administrative difficulties and litigations. The yield from the levy also has not been significant so far.

Despite its inclusion in the tax base in most States, rebate on agricultural land in the non-scheduled States currently accounts for nearly 3 to 4 per cent of the revenue loss caused by rebates and exemptions. If lands

situated in the scheduled States also are left out, the leakage will presumably be much larger.

What is more, there is no definition of agricultural land in the ED Act. What constitutes agricultural land has been a source of dispute and has gone up for judicial attention in many contexts. The distinction was important even when estate duty was leviable on agricultural land because of the concession in duty allowed for agricultural land included in small estates and the rebate on agricultural land granted for lands situated in the non-scheduled States. With total exemption as proposed now, the question will acquire further importance since the taxability of vacant lands will depend crucially on the character of the lands in question. In the absence of any definition in the Act, the treatment of a given piece of land in borderline cases will depend largely on judicial rulings.

Following a decision of the Madras High Court in Sarojini Devi v. Srikrishna for a long time the criterion used in deciding the character of any vacant land was whether it was used or capable of being used for agricultural purpose. Since all vacant land unless totally barren can be put to cultivation, it was possible to claim tax concession for lands situated even in the heart of big towns as agricultural and it was not easy for revenue authorities to deny such claims.

After a good deal of uncertainty over many years the Supreme Court handed down a ruling in 1976 in the case of CED v. Venugopala Verma Raja which had the effect of narrowing down the ambit of "agricultural land" somewhat.

Following its earlier decision in a wealth tax case (CWT v. Officer-in-Charge, Court of Wards, Paigah), the Supreme Court had laid down that in deciding the character of a given piece of land it is not merely potentiality but its actual condition and intended user which has to be taken into account. "What is really required to be shown is the connection with an agricultural purpose and user and not the mere possibility of user of land, by some possible future owner of possessor for an agricultural purpose." The ruling by the Supreme Court no doubt has reduced the scope for revenue leakage from exemption of "agricultural land" considerably. Even so, the possibility of disputes regarding the character of lands around growing cities remains since the matter will now depend largely on the facts regarding actual use. The value of such lands invariably goes much beyond what is warranted by their agricultural potential and there can be little justification for their exclusion.

To avoid disputes and prevent revenue loss a definition of agricultural land similar to that contained in Section 2(14)(iii) of the IT Act should be incorporated in the ED Act also to remove all doubts if it is finally decided to exclude all agricultural land from the tax base.

It would however be preferable to continue the inclusion of agricultural land in the principal value of estates for ED purposes. For, apart from the damaging effect on the base and the efficacy, tax-exemption for any particular item of asset such as agricultural land creates distortions and violates equity. It is to be noted that concessional treatment of agricultural land for death duties in UK has invited criticism from experts as

it does not really help anyone except farmers in possession of big farms as the concession gets capitalized through higher land values (Kay and King, 1980). Despite difficulties of valuation, there is no reason why agricultural land should be excluded from the purview of the estate duty especially when gift tax is leviable and the Supreme Court has upheld the power of the Centre to levy the gift tax on agricultural land (GTD v. D.H. Nazarath). Valuation should not also pose an insuperable problem if based on potential yield as data on yield are now available in most parts of the country. The question, it is submitted, requires reconsideration.

(iii) <u>Operation of personal law of Mitakshara Hindus.</u> Under the personal laws of Hindus belonging to the Mitakshara School, a male child born in a Mitakshara Hindu family acquires an interest in the joint family property right from birth, equal to that of his father and other brothers and on the death of the father, the sons inherit the property not as his heirs but by survivorship. This is called the coparcenary interest. As a result of the operation of this law, when the father of the family dies, what passes is his interest at the time of his death, that is, only a fraction of the family estate. The fraction has to be determined on the basis of a notional partition of the family properties on the date of death and in such a partition sons of the deceased along with his wife have to be allocated equal share (Hindu widows are also treated as coparcenary for all practical purposes vide ruling of the SC in CED v. Alladi Kuppuswamy).

The operation of the Mitakshara law creates an acute inequity in the incidence of estate duty as between property owners belonging to different schools of Hindu

Law and to other communities, apart from the fact that it acts as a serious constraint on the efficacy of the ED as an equalizer of inherited wealth. The burden of ED for estates governed by Mitakshara school and others are shown in Table 2. In a case where the head of a family owning an estate of Rs 10 lakh and consisting of 4 male members dies, the duty is Rs 2,15,000 if the family is governed by the ordinary law of succession but would come to only Rs 53,750 if it belongs to the Mitakshara school. No duty is payable if there are 7 coparceners.

Under the present law, the coparcenary interest of all lineal discendants of the deceased is aggregated in the principal value of the estate passing on his death but rebate is allowed at the average rate on the share of other coparceners so that only the deceased's interest is subjected to tax. Even so, as the table shows, there is considerable disparity in the liability to estate duty as between persons belonging to different schools of Hindu law.

With the existing system of personal laws it is not easy to find a solution to the inequity and the leakage of revenue caused by this factor. One solution could be to put the deceased coparcener's interest on the top slabs of the principal value while determining the tax payable. This will help to reduce the inequity to some extent as brought out in Table 2 (vide figures under cols. b).

TABLE 34

Comparison of Incidence of ED for PV Under Dayabhaga and Mitakshara Schools

P.V. (Rs)	Tax payable under Dayabhaga rule (Rs)	Tax payable (Rs) under Mitakshara rule with co-parceners numbering							
		2		4		5		7	
		(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
2,000,00	5,000	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
5,000,00	65,000	32,500	42,500	Nil	Nil	Nil	Nil	Nil	Nil
10,000,00	2,15,000	1,07,500	1,50,000	53,750	75,000	43,000	70,000	Nil	Nil
20,000,00	6,65,000	3,32,500	4,50,000	1,66,250	2,50,000	1,33,000	2,00,000	95,000	1,42,857
50,000,00	32,15,000	16,07,500	21,25,000	8,03,750	10,62,500	6,43,000	8,50,000	4,57,143	6,07,142
1,00,000,00	74,65,000	37,32,500	42,50,000	18,66,250	21,25,000	14,93,000	17,00,000	10,57,143	12,14,285

Note: (a) Under the existing system

(b) Where the share of the deceased co-parcener is placed on the top slab of the P.V.

(iv) Immovable property situate outside India and movable settled property in certain cases. Following the British practice under the ED Act, all property situated outside India is, in all circumstances, exempted from duty. As regards foreign movable property, if the deceased happened to be domiciled in India, no exemption is available. If, however, the deceased was domiciled outside India, no estate duty was payable in respect of foreign movable property except in the case of settled property where the settlor was domiciled in India when the settlement took effect. In other words, broadly speaking, immovable property situated abroad is totally outside the tax net, and, similarly, movable property situated abroad is also not taxable unless the deceased was domiciled in India. Whatever might have been the logic underlying these provisions when the ED legislation was enacted, they seem to require reconsideration to strengthen the base and improve equity.

If this tax is to fall equally on estates of equal size, there is no reason in equity for excluding foreign property from the base where the deceased happened to be a citizen of the country. Under the CTT now in operation in the UK, all properties of a domiciled individual, whether situated at home or abroad, are chargeable to duty. For other people, only property within the United Kingdom is included. Settled property situated abroad of which the deceased was a life tenant is excluded unless the settlor happened to beadomicile at the time the settlement was made. There is no requirement that the deceased should be domiciled in the country imposing the tax at the time of death. Foreign immovable property is excluded from the PV possibly on the

consideration that recovery of the tax can be a problem and the country where it is located is in a better position to tax it and in any case no country is likely to give up the right to tax immovable property located within its frontiers. While there is some force in this argument, it does not follow that the value of such property cannot be included in the PV at least to determine the rate of tax in respect of the property situated within the country.

The problem was tackled in Sri Lanka by making a distinction between a deceased's "total estate" and "Sri Lankan estate". "Total estate" covered all property, wherever situated, and "Sri Lankan estate" included all property except immovable property held outside Sri Lanka. The duty was charged on the value of "Sri Lankan estate" at the rate payable on the value of the "total estate," (Gulati, I.S., 1957). Similar provision also exists in Canada and now in UK.

It is, therefore, suggested that in the case of a person domiciled in India, foreign assets, whether movable or immovable, should be included in the PV at least for purposes of determining the rate of duty on assets situated in India.

In this connection, since ED liability depends crucially on the location of assets, it is necessary to spell out the criteria to be applied in determining situs. Rules 8 and 9 of the ED Rules lay down the criteria to be followed in this regard. These however were fixed long ago and need to be revised. The principles suggested by the

Asprey Committee for the purpose seem to be well thought out and might be considered for application in India (Appendix II.3).

The concept of "domicile" also may be revised on the same lines as in UK under the CTT. Under the scheme of the CTT the term domicile has a wide connotation. A non-domiciled person is deemed for CTT purposes to be domiciled in the UK at the relevant times if any one of the following conditions is satisfied:

(a) he was domiciled in UK on or after 10th December, 1974 and within the three years immediately preceding the relevant time; or

(b) he was resident in the UK on or after 10th December, 1974 and not less than 17 of the 20 years of assessment ending with the year of assessment in which the relevant time falls; or

(c) he has, since 10th December, 1974, become and has remained domiciled in the Channel Islands or Isle of Man and, immediately before becoming domiciled there, he was domiciled in the UK (Board of Inland Revenue, Capital Transfer Tax, 1977)

For purposes of (b) above, the question whether a person was resident in the UK in any year of assessment must be determined as for income tax without regard to any test with reference to any dwelling house available in the UK for his use.

Sometimes controversy arises as to the actual domicile of a person dying in India. Although a foreigner might have been living in India for a number of years it becomes difficult to treat him as domiciled in India in the

absence of any specific proof, for which the onus lies with the department, to establish that he relinquished the domicile of origin and opted for Indian domicile. Obviously, to overcome such difficulties, the UK Act has now provided an alternative test for determination of domicile on the basis of residence under the Income-tax Act. This approach has also received the approval of the Madras High Court in a recent case (CED v. Dr. Ida Belle Scudder). Following this judicial sanction, suitable provision may be made in ED Act for determination of domicile on the basis of length of stay in the country.

There are a number of other items for exemption which call for review. One is a special provision relating to rulers of former Indian States. With the exemption now available for one residential house there is no need for a separate exemption for residential building of former rulers.

Apart from the exemption for one residential house upto Rs 1 lakh among the items for which exemption is available upto certain monetary limits, the notable ones are: gifts made in consideration of marriage upto Rs 10,000 and gifts to meet the normal expenditure of the deceased also upto a sum of Rs 10,000 and household goods, tools, implements, etc., upto Rs 2,500. Gifts upto Rs 10,000 made on the occasion of the marriage of a dependent relative or gifts of insurance policies to any dependent other than wife upto a maximum of Rs 10,000 in the aggregate in one or more previous years in respect of each such donee are also exempt from GT.

With the proposed integration of gifts and bequests, the exemptions for gifts for marriage made within the critical period should also be integrated with exemptions for the same purpose under the ED Act. Keeping this in view and also the impact of inflation, the limits for this may be raised to Rs 30,000 for GT and ED taken together. For gifts made beyond the critical period the exemptions for marriage and normal expenditures now available may continue. Exemption may be granted also for gifts upto a maximum of Rs 5,000 a year for each dependent child inclusive of expenditures on education. The exemption granted for gifts of policies of insurance or annuities to dependants other than wife may be withdrawn.

The exemption for household goods, tools, etc., of upto Rs 2,500 was fixed long ago and is evidently inadequate. Identification of household goods and their valuation pose difficult problems. In very few cases the value of household goods of any substantial amount is included in the principal value. To require an account of household goods to be submitted for estate duty and, what is more, to verify such accounts is to intrude too much into the privacy of donees and legatees of estates. Considering the impracticability of bringing households under taxation, it would be desirable to exempt all household goods except identifiable consumer durables of more than a certain value, say Rs 3,000 each (at cost) and all items of jewellery.

As mentioned earlier, there are a few items of exemption which are aggregated in the principal value for rate purposes and relief is granted on such items at

the average rate of duty. The most important items in this category are insurance policies assigned for payment of estate duty and deposits towards payment of estate duty to the extent of duty payable or Rs 50,000 whichever is less. This seems to be too large a concession. At the current rates PV on which ED is Rs 50,000 works out to about Rs 4,40,000.

This item of exemption is peculiar to the Indian system and is not-to be found either in UK or in any of the countries of the British Commonwealth. Such policies for payment of estate duty or deposits made with the Government in anticipation of the liability are also available in UK where they are not only aggregable but also liable to tax. In fact one of the commentators on the Indian estate duty has remarked that "The underlying purpose of the Indian Government in providing for this exemption is a matter for speculation." An individual is free to make any arrangement so that his heirs and successors are not devoid of cash at the right time for the payment of estate duty but this itself is no justification for granting exemption in respect of amount so deposited or the value representing the insurance policy. These exemptions may, therefore, be withdrawn especially if the allowance for tax-free transfers to spouses and minor children is given as suggested here.

Exemption is also available at the average rate, on amounts received from life insurance policies after the death of the deceased to the extent of Rs 5,000. Here also the position in India is different from either the UK or other countries of the Commonwealth. Under the CTT in UK the amount due on a policy of life insurance after the death

of the person/insured is includible in the property passing on death. This exemption does not seem to be required if allowance for spouses and minor children are granted separately, as proposed here.

Apart from exemptions, set off is allowed against duty payable under the ED Act to provide relief in certain cases, viz., for avoiding double taxation, for quick succession to property, for court fees paid for obtaining representation to the estate of a decedent, for gift tax paid in respect of properties included in the PV and for capital gains tax paid on gains made for transfer of asset within a period of two years from death. There is also a provision for commutation of duty in respect of interest in expectancy. These provisions are unexceptionable and should continue. Only the provision allowing relief for capital gains tax needs some attention.

As it stands now, the objective of the existing provision for granting relief for tax paid on capital gains on assets transferred within two years after death is not quite clear. Presumably the provision is designed to avoid double taxation of capital gain arising from the taxation of the accrued gain upto the date of death through the estate duty and again under income tax when the asset is sold and the gains are realised. The scope of the present provision, however, goes beyond this objective. The relief is now calculated on the basis of the following formula :-

$$R_{ED} = T_{CG} \quad X \frac{E}{P}$$

Where R_{ED} is the relief in estate duty leviable under the section, T_{CG} is the tax on capital gains, E is the net

estate duty payable after giving all reliefs and P is the sale proceed of the asset. It will be seen that where the entire sale proceeds are applied towards payment of estate duty, the tax on capital gains is set off in full against the estate duty payable for the estate. It is conceivable that in some situations the capital gains tax would exceed the estate duty payable for the total estate. On the other hand the provision may result in total relief from capital gains tax by virtue of the set-off against ED even though the gains accrued largely after the date of death.

Logically, for avoiding double taxation, the relief in estate duty on account of capital gains tax should be restricted to the estate duty charged on the accrued capital gains from the asset. The relief, therefore, should be provided in capital gains tax rather than in ED by calculating the ED paid on the accrued capital gain as on date of death.

c. Under-valuation of assets. The analysis presented in Part I of the report brings out that one of the principal factors responsible for stagnation in the base of the ED is under-valuation of properties. It was noted that average value of movable properties per estate assessed has gone up from about Rs 27,000 in 1960-61 to Rs 54,000 in 1979-80. The average value of immovable non-agricultural property has registered very little growth. The average total value of estates has decreased over the year (vide Table 14, Part I). While this could be due partly to a decline in the shares of large estates among the estates coming under the ED, it is evident that valuation of assets has fallen far behind their market worth.

The problems of valuation have been discussed briefly in Part I of the report. Valuation of immovable property is now required to be made largely on the basis of the yield and, with rent control in operation, the yields of old properties in big cities are invariably depressed. Underreporting of true values in transfer deeds has further compounded the problems of valuation. The problem does not admit of any easy solution. Some improvement can, however, be achieved in valuation if information regarding transactions in properties is collected in a systematic manner in the estate duty offices. Reliable information regarding property transactions can be obtained at least in the case of transactions in which the Government or semi-government organisations happen to be a party.

The system of having valuations certified by approved valuers does not seem to be working too well. To improve the system of valuation for ED it would be useful to provide for reference to the valuation officers to whom reference is now made for income tax and wealth tax purposes.

It is sometimes suggested that valuation for ED should be the same as that for WT. No doubt revaluation of assets already taxed to WT on the death of an estate owner can be a source of annoyance and harassment to APs. If all assets are valued properly at market rates for the WT there can be no justification for revaluation on death. If, however, periodical revision of the value of all assets is found impracticable or undesirable for WT, there is no alternative but to make a fresh valuation for purposes of the ED. For valuation for ED should be as close as possible to the market value except where a concession is given specifically and such concessions are better given by

raising the exemption limit suitably instead of keeping down the valuation.

Valuation of interest in property of several other types also (e.g., business assets) gives rise to difficulties. Instructions have been issued by the administrative authorities which on the whole try to adhere to the scheme of the Act. It may only be added that valuation of the interest of a deceased who has transferred assets to a controlled company is made under a special provision (The Controlled Companies Rules). The idea is to take the same slice of the company's assets as the benefit received by the deceased in the three years preceding his death bears to the income or profits of the company. This is designed to prevent avoidance by transfer of assets to controlled companies. As pointed out by the Asprey Committee, there is no strong reason for retaining this provision in a system where life-time transfers are taxed. The provision may therefore be removed. It will reduce the administrative burden considerably.

Valuation of the share of a deceased partner in a partnership firm has given rise to litigation and has been a source of base erosion in ED. Often, the partnership deeds provide that the share of a deceased partner may be acquired by the remaining partners or a nominee of the deceased at a stipulated price even if that happens to fall below the true value of the share. In such cases some courts have held that the value of the share of the deceased partner has to be determined in accordance with the terms of the partnership deed and that the figure mentioned in the deed alone can be taken to be the value of the share

passing on his death. Instructions along these lines have also been issued by the Central Board of Direct Taxes. This approach however is not consistent with the rationale underlying the ED. In principle, for purposes of the ED the value of a partnership share should be properly assessed, irrespective of the value mentioned in the deed. This approach has also been recommended by the Asprey Committee of Australia. However, it should be provided that in such cases the tax payable on the value as per the amount mentioned in the deed of partnership should be borne by the legatees of the deceased's estate while the tax on the balance should be borne by either the surviving partners or the nominee as the case may be. This line of reasoning has received judicial approval (CED v. J.G. Apcar) and may be followed in all cases.

Transfer of assets to investment companies has been a device for avoidance. The proposal in the 1983-84 budget for levying a tax on certain assets of companies goes some way to neutralise the advantage of such transfers. Even so, every attempt should be made to value the shares of such companies on a proper valuation of their assets.

d. <u>Deductions</u>. Under the ED Act, deduction is admissible in computing the PV on account of genuine liabilities and a few specified items of expenditure like funeral expenses. Some restrictions are, however, laid down to guard against avoidance by claiming deduction for liabilities not genuinely incurred and also against assets which are exempt. But the scheme of the relevant provisions does not seem to be adequate to achieve this purpose.

The scope for avoidance arises from the absence of any clear prohibition of deduction of liabilities charged against assets not liable to duty. This was brought out in a case where the deceased owned a residential flat exempt u/s 33(1)(m), acquired by him partly with funds borrowed from his provident fund account and insurance. Deduction of these liabilities from the PV of the estate was refused by the assessing authorities on the ground that these related to an exempt asset and the liabilities accordingly were set off against the value of the exempt property. The deduction was, however, allowed by the appellate tribunal on the ground that the gross value of the property should be considered for exemption u/s 33(1)(m) and there was no bar to the deduction under the conditions laid down in Section 44 of the ED Act governing the deduction of liabilities.

In countries where ED is in force, debts are deductible from the estate as a whole but where a debt relates to an exempt asset it is either disallowed or set off primarily against the exempt asset and deduction is allowed only for the excess, if any (OECD, 1979). Despite their restrictive conditions the sections governing the deductions of debts under the Indian ED Law seem to be a little too wide in this respect and need to be tightened up.

Some tightening is needed also to ensure that foreign debts are set off only against assets liable to duty in India. Under the existing provisions no deduction is allowed in respect of foreign debts in the first instance except against foreign properties on which duty is payable, namely, foreign movables belonging to a decedent who was domiciled in India (Section 47 of the ED Act). The second

part of the same Section, however, allows deduction of foreign liabilities in excess of dutiable foreign estates against assets situate in India. Such a deduction is allowable even where the deceased happened to possess properties abroad which are not subject to estate duty in India (e.g., foreign immovable property). The position now obtaining in the law can be seen from the following example:

	Rs
Property in India	5,00,000
Immovable property in foreign country A	1,00,000
Movable property in country A	1,00,000
Immovable property in foreign country B	2,00,000
Liability of the deceased as a citizen in country A	3,00,000

The gross value of the estate in this case is Rs 6,00,000 (property in India Rs 5,00,000 plus movable property in country A). But the foreign liability of Rs 3,00,000 in country A has to be set off first against movable property in country A, i.e., Rs 1,00,000. The remaining Rs 2,00,000 has to be set off against immovable property in foreign country A which is the country of residence of the creditor, (Alagappa Chettiar v. CED). It has been laid by the courts that where the immovable property in the country of the creditor is insufficient, the balance can be set off against assets in India under the second part of Section 47 (CED v. Xoc Cadar Xec Usman). The deduction of foreign debts against dutiable assets when the deceased was in possession of immovable property abroad (country B in this case) goes beyond the requirements of equity. The provisions

governing the deduction of liability (particularly Section 47) need re-examination. The proper course would be to provide clearly that foreign debts are first set-off against movable properties abroad, then foreign immovable properties and then against dutiable assets.

e. Administration. The task of an administrative authority entrusted with the responsibility of enforcing a tax is broadly three-fold : (i) to ensure that all cases liable to pay the tax are brought within the fold; (ii) the assessments are made correctly and demand raised without any undue delay and, (iii) the tax due under the law is collected in time. Any deficiency in the first two areas would show up in the slow growth of the amount demanded while lags in collections lead to lack of growth in revenue relatively to demand.

Our analysis in Part I showed that the poor elasticity of the yield of the ED with respect to factors like property prices is attributable more to the slow growth of demand rather than sluggishness in collections relatively to demand. The elasticity of collections with respect to demand during 1969-70 to 1981-82 works out to 1.47 (which is statistically significant). That the poor yield cannot be blamed on laxity in collections is also evidenced by the arrear position in ED as compared to that of income tax, wealth tax and gift tax (Table 3). The proportion of tax outstanding to demand raised annually is not too high in ED cases as compared to other capital taxes; and also does not compare very unfavourably with income tax. The proportion of total collections to total demand in ED is appreciably higher than in WT and GT though not as high as in income tax. Surprisingly the arrear position seems to be worsening in the GT in recent years.

TABLE 35

Proportion of Arrears to Current Demand and of Total Collections to Total Demand in Direct Taxes

(1978-79 to 1981-82)

Year	Proportion of arrears* to demand raised in the year (per cent)				Total collections during the year as percentage of total demand**			
	Income tax	Wealth tax	Estate duty	Gift tax	Income tax	Wealth tax	Estate duty	Gift tax
1978-79	156.26	25.67	177.68	40.39	70.13	26.66	60.73	27.73
1979-80	131.75	167.94	212.41	217.51	79.06	30.82	66.43	35.21
1980-81	133.32	188.63	105.41	77.94	80.22	23.35	58.04	18.22
1981-82	133.78	302.38	79.75	414.76	72.11	25.29	62.53	21.54

Note: * As at the beginning of the year

** Both arrear and current

Sources of basic data: 1. Directorate of Inspection (RS&P), Monthly Progress Reports, New Delhi.

2. Explanatory Memorandum on the Budget of Centra[l] Government.

The proportion of total collections to total demand in ED has not gone below 60 per cent in recent years (except in 1980-81) while in GT, it has gone down to only about 20 per cent. One reason for the comparatively good collections in ED probably is the requirement of provisional payment before any clearance.

The sample survey carried out for this study showed that even among cases pending for more than 5 years, provisional demand was raised in 85 per cent of the cases (Table 4) and in about 88 per cent, the provisional demand had been realised (Table 5). Hence, as noted in Part I, the causes of low yield of the ED have to be looked for on the side of demand rather than in lags in collection.

As for causes underlying the slow growth in demand, an attempt was made to investigate to what extent sluggishness of demand was due to failure to book new cases or delays in assessment and how far this is caused by lack of growth in the assessed value of estate due to undervaluation, the reasons for which have already been discussed. It is found that the number of effective assessments in ED has increased but is marked by fluctuations. It went up to over 17,000 in 1976-77 but declined to 12,137 in 1980-81. There is reason to think that either the number of new cases is not increasing or assessments are lagging behind. Table 25 in Part I showed that as of March 31, 1981, nearly 36,000 ED cases were pending for assessment. Of these about one-fifth were started more than five years ago. From a sample survey of cases pending for more than five years it appears that about one-fourth of these cases are more than 10 years old (Table 6). It is evident that a large number of cases - mostly involving large estates - remain pending in ED for long periods.

TABLE 36

Distribution of Provisional Assessment

Item	Percentage to total
Prov: assessment made	85.35
Not made	14.65
Total	100.00

Source: Sample survey by NIPFP

TABLE 37

Proportion of Cases Where Provisional Demand Paid

Item	Percentage to total
Provisional demand paid	87.50
Not paid	12.50
Total	100.00

Source : Sample survey by NIPFP.

TABLE 33

Distribution of Cases Pending for More Than 5 Years as on 31.3.1982 According to Length of Delay

Delay (years)	Ahmedabad		Bombay		Calcutta		Delhi		Kanpur		Total	
	Number of cases	Number of cases as per cent of the total	Number of cases	Number of cases as per cent of the total	Number of cases	Number of cases as per cent of the total	Number of cases	Number of cases as per cent of the total	Number of cases	Number of cases as per cent of the total	Number of cases	Number of cases as per cent of the total
5 - 6	2	25.00	2	11.76	7	33.33	10	55.56	0	0.00	21	32.31
6 - 7	1	12.50	5	29.41	4	19.05	0	0.00	0	0.00	10	15.38
7 - 8	2	25.00	0	0.00	3	14.29	3	16.67	1	100.00	9	13.85
8 - 9	0	0.00	4	23.53	1	4.76	1	5.56	0	0.00	6	9.23
9 -10	1	12.50	1	5.88	0	0.00	1	5.56	0	0.00	3	4.62
More than 10 years	2	25.00	5	29.41	6	28.57	3	16.67	0	0.00	16	24.62
TOTAL	8	100.00	17	100.00	21	100.00	18	100.00	1	100.00	65	100.00

Source: Sample Survey by NIPFP.

What precisely accounts for the delay is difficult to identify. A look at some of the old cases in Bombay and Calcutta indicated that various factors are responsible for holding up the ED assessments. In some cases, the assessment could not be proceeded with because of disputes relating to the title of the deceased to some valuable properties, while in some, the assessments got stalled for lack of co-operation from the accountable persons. Quite often, the APs lose interest in the case after the provisional ED clearance certificate is issued. The delay is, however, attributable to a large extent to lack of adequate attention on the part of the assessing authorities. Cases which are pending for long are invariably those which involve some problem and, therefore, require more attention than others. But pressure for disposals understandably causes an aversion among assessing officers towards old cases as they bring little reward in terms of number of disposals.

The system of obtaining approval of higher authorities also seems to be another factor responsible for holding up disposal of cases involving large estates. Under executive instructions, cases where the assessed PV ranges between Rs 5 lakh and Rs 20 lakh are to be approved by Deputy Controllers of ED while those with PV exceeding Rs 20 lakh require the approval of the Controller of ED. The system of approval is time-consuming. Not unoften, cases put up for approval from below are sent back for some further inquiry or examination which usually gets a low priority from the assessing officers as compared to cases which they themselves can dispose of.

If the disposal of pending cases is to be speeded up some experienced officers - and there are extremely knowledgeable and earnest officers in the ED circles in Centres like Bombay and Calcutta - should be spared from routine work and allowed to concentrate only on such cases without any pressure for numbers. Simultaneously, the systems obtaining earlier for assigning the jurisdiction over cases involving PV exceeding a certain value (say Rs 20 lakh) to the Deputy Controller may be revived so that the responsibility of not merely approval but completion of big cases lies with them.

The staff position of the ED circles also needs to be strengthened. Available information showed that vacancies in ED circles remain unfilled for long periods, resulting in pressure on the existing staff. There should also be some special incentive for working in an ED circle. The ED Act is a notoriously complex piece of legislation and its administration requires knowledge of laws not only of ED but also of several other areas like succession, transfer of property, Hindu law, etc. as also investigative skill of a high order. Officers working in ED circles deserve special pay more than perhaps in any other area of the Income Tax Department.

In order to prevent accumulation of arrears, some time limit for completion of assessments, appears to be necessary. A similar suggestion has also been made by the Choksi Committee and they have also recommended some period for purposes of limitation. While there is need for harmony with the provisions of other direct taxes Acts in this respect, it is also necessary to remember that estate duty

assessments sometimes involve acute complexities and in any case should not be completed until the completion of assessment, if any pending, under the IT and/or WT Acts. It will, therefore, be desirable to lay down an alternative period of limitation linked to the end of the last financial year in which assessment under either of these two Acts is completed.

The system of booking cases also calls for some attention. Discussion with ACsED of the charges selected for the study showed that there is no uniformity in the matter of reporting of deaths for purposes of ED. Maintenance of records of births and deaths is the responsibility of the State government agencies. While in cities and metropolises this is the responsibility of Municipal Corporations/Municipalities/Local bodies and Cantonment Boards, in the villages such function is performed by the village pradhan/headman. Under the ED Act there is no statutory obligation on the State government authorities to furnish information about deaths to the IT Department. Under administrative arrangements, the Central Information Branch in the charge of each CIT is required to collect this information from the concerned authorities and then pass them on to the ACsED. In Bombay it was learnt while report of deaths used to be received by the ED authorities regularly earlier, these are no longer being received now for reasons not known. It was further learnt that lack of man-power also caused problems in following up the information received. In Ahmedabad information regarding deaths is being received only from one taluka office in the territorial jurisdiction of the CED, Ahmedabad extending over the districts of Ahmedabad, Surendranagar, Banaskantha, Sabarkantha and Mahsana. While the position is the same in

Delhi, in Kanpur information regarding deaths is collected from the municipal office. Thus there is no systematic procedure for collection of information regarding deaths from the records of the relevant authorities.

The ED Act provides for statutory reporting of deaths by controlled companies, companies incorporated outside India and domestic companies under Sections 18, and 84 of the ED Act respectively. While most of the ACsED felt that the provisions of these sections are generally being compiled with by the concerned companies, they admitted that they had no machinery to check the same. By and large the ACsED in the charges selected for study are mainly relying on one or more of the following sources for finding new assessees:

(i) Applications received under Section 56 for exemption/clearance certificate.

(ii) ED-IA filed under Section 55 or application for extension of time for submission of such account.

(iii) Statutory intimation from companies referred to earlier.

(iv) Intimation from LIC regarding payment of claim above a certain limit.

(v) Copies of intimation sent by the Trustees of Provident Fund to the APs/heirs for production of exemption/clearance certificates.

(vi) Intimation, if any, from concerned authorities of the State government responsible for maintenance of records regarding deaths.

(vii) Anonymous complaint petitions.

(viii) Cases detected by the Inspector in the course of some other enquiry and intimations from ITOs assessing the deceased under the IT and/or WT Acts as per existing instructions of the CBDT.

The sample survey showed that for discovering new cases the ACsED are relying almost wholly on voluntary compliance by APs (Table 26 in Part I). This is not a very satisfactory state of affairs. The remedy seems to lie in forging some arrangements by which authorities under the State government are statutorily responsible to intimate information regarding deaths to the nearest ACED. Some legal framework already exists in Section 81 of the ED Act which empowers the Central government to make arrangement with the government of any State for the exchange of such information as may be necessary for purposes of levy and collection of estate duty under the ED Act. Greater use should be made of this provision to facilitate administration.

It would help administration and also remove hardship if the procedures are simplified. Lines on which procedure can be simplified for the benefit of small estates have already been indicated in Part I of this Report. One more area in which simplification can be effected is to do away with the need of swearing the ED return before a

magistrate or a notary. There is no such requirement under the other direct taxes laws. Yet this does not stand in the way of prosecution or other penal measures for offences. Removal of the requirement of swearing the return would enable widows to subm. the accounts of assets themselves without the need of appearing before a magistrate or notary through a lawyer.

The procedure for granting relief for quick succession should be simplified to cut down delays. The existing system of obtaining the approval of the Central Board of Direct Taxes does not seem to be necessary. Further, the application of quick succession relief should be based in the light of the spirit of the provision and not on a narrow legalistic interpretation. It appears that in some cases, the relief was denied on the ground that the balance in provident fund assessed on the first death had taken the form of bank balance at the time of the second death and therefore "the same property" was not subjected to duty. This does not seem to be a reasonable approach.

Unlike in the case of the Income-Tax Act, the Estate Duty Act does not require the Assistant Controller to issue any notice to the accountable person for submission of an account before completing assessment ex parte under sub-section (4) of Section 58. This lacuna may be remedied by making suitable provision for issue of notice calling for submission of accounts before resort to Section 58(4) of the ED Act.

Similarly, unlike in the Income-Tax Act there is no provision for re-opening of an ex-parte assessment under the Estate Duty Act and the only remedy is an appeal to the appellate authority. This may act harshly in the case of

small assessees. It is, therefore, desirable to make a provision in the ED Act for the reopening of an assessment on the AP satisfying the ACED regarding the cause of non-submission of accounts within the statutory period.

There should be a provision for charging interest for (late) filing of return and for non-payment of duty mandatorily, with powers to the Controller to waive the interest in appropriate cases. Guidelines in this regard may be laid down by the CBDT.

There is no provision in the ED Act corresponding to Section 263 or 264 of the Income Tax Act which gives revisionary powers to Commissioners in suitable cases and cases where the taxpayer requests for revision within a specified period. It is helpful to APS and also necessary in order to safeguard revenues.

Certain measures seem needed to streamline the collection procedure and machinery. Unlike in the case of the other direct taxes laws, collection of estate duty is assigned to the revenue authorities in the States; a certificate is issued by the Assistant Controller to the Revenue Collector in the district who collects the arrears of estate duty in the same manner as arrears of land revenue. This causes delay. The collection procedure through recovery certificates may be brought in line with the system in other direct taxes.

f. <u>Other areas of reform</u>. Other areas in which changes in the law or procedure would help administration, reduce scope for avoidance and minimise hardship are briefly indicated below:

(i) Benefits are being increasingly availed of by employees in the organised sector in a form which eludes the net of the ED in the event of their death. Examples are: leave salary, group insurance benefits, Payments made because of special risks attaching to the job and amounts paid in the event of death in service though allowed in every case often described as "compassionate" benefits. These are claimed as exempt, being interest in which the deceased never had any vested right. Disputes over the taxability of such items surfaced in the case of H.C. Khanna v. ACED and CED v. R. Ramanujam. In the interest of revenue and also uniformity and equity (small estates may not get the benefit as they may not be in a position to go to the court) it is necessary to make it clear that all payments actually received from an employer by the heirs of a deceased employee should be included in the ED base in the same way as proceeds of insurance policies irrespective of whether the deceased had any vested right therein or not. The basic exemption should take care of hardship, if any, to legatees of small estates. In addition, exemption may be given specifically for payments on death due to accident while on duty.

(ii) Premia paid on policies taken under the Married Women's Property Act should be deemed to be gifts inter-vivos. The Choksi Committee also drew attention to the need for a clarificationary amendment on this issue.

(iii) At present, refund of duties paid cannot be refused in cases where the tax department prefers an appeal against the order of the appellate authorities even if there is reason to believe that such refund may be prejudicial to revenue. There is a provision in the IT Act to bar refund in

such cases. A similar provision may be incorporated in the ED Act too. However, interest should be paid on delayed refunds.

(iv) ED should not be allowed to be deducted from the PV as a liability. The position seems to be unclear at present. It is noticed that duty provisionally payable for large estates is often reduced in this manner with consequential loss to revenue in terms of interest.

(v) Under the recent amendment, rule 1BB of the WT Rules has been made applicable to one residential property in ED assessments, whether the property is owner-occupied or not. The extension of the rule to properties other than one self-occupied house does not seem to be justified, or even intended and so the position needs to be made clear.

(vi) An ingenious method of avoiding ED has been devised drawing on the decision of the House of Lords in the well-known Rally's case, known as the method of "grafting". Duty is avoided by this method by the purchase of an interest in expectancy by the life tenant so that when the life tenant dies no property passes to the remainderman. It seems this device has been resorted to in some cases in Bombay. Some legislative action seems needed to stop this practice.

(vii) A few sections of the ED Act seem to have lost their rationale with the passage of time and may be deleted, e.g., section 25 (income of settled property acquired on death of spouse) and section 29 (settled property in respect of which duty has been paid on the death of the deceased spouse).

These two sections would also become all the more unnecessary if gifts and bequests are integrated even partially and transfers between spouses are exempted. Section 29 does not seem to be required in any case as in normal circumstances the quick succession relief provision should take care of the problem. Section 8 also seems to be redundant as gifts made within the critical period will be included in the PV under the proposed scheme.

(viii) Under recent notification (No. GSR 513 of April 29, 1980) issued under the ED Act, relief is granted under Section 33(2) to bequests for charities. But gifts to charities made within six months before death are taxable. This is anomalous. If gifts to charities taking effect after death are exempted, there is no reason why such gifts if made before death should be taxed. The anomaly should be removed.

(ix) Although section 7 provides for levy of duty on interest ceasing on death, in a case where the deceased have right to reside in a property free of rent, duty could not be charged on the value of such right ceasing on death because of a ruling by the High Court to the effect that such an interest, if it is to be deemed to pass, must extend to the whole or part of the <u>income</u> of the property (D.J. Gajdar v. CED). Since in this case the deceased did not have any interest in the income of the property, such interest, it was held by the court, could not be computed in the manner provided in the ED Act and rules (rule 40). This can be a source of considerable base erosion and needs to be guarded against. Right to reside in a house or part thereof can be valued on the basis of prevailing market rents.

Concluding remarks

A number of suggestions have been put forward in the preceding paragraphs for the reform of the capital taxes in India. Though the focus is on improvement of the operation of the ED and the GT, the suggestions embrace the wealth tax and capital gains tax also. Based on the conclusion that taxes on inheritances and gifts have an important role to play in the tax system, the reform proposals seek to indicate the lines on which legislative and administrative measures may be taken to strengthen their efficacy, improve equity, remove anomalies and reduce hardship.

The main objective of the various suggestions put forward in this study is to ensure that the base of the transfer taxes is widened while the rates are reduced. No doubt, as argued by the Asprey Committee, a highly progressive tax on estates passing on death does not have the ill effects of progression in income tax. Nevertheless, it cannot however be overlooked that progressive rates by themselves are of no avail and often lead to evasion which cannot be easily countered. Therefore, while maintaining a degree of progression in the rates, it is necessary to see how the base of the ED and the GT can be widened so that the effective incidence does not diverge widely from the nominal rates.

Administration of taxes is not simple anywhere, more so in India with under-staffed and poorly equipped offices. The task of administration can however be simplified a lot if the taxes are well-structured and the laws oriented clearly to the objectives. It is hoped that the exercise undertaken here would be of some help towards this end.

A NOTE ON SECTION 10 OF THE ESTATE DUTY ACT, 1953

Under the scheme of transfer taxation in India bequests are taxed independently of life-time gifts. Gifts inter vivos are ordinarily not liable to be included in the principal value (PV) of the estate if made beyond two years before death (gifts to charity made beyond six months are not included). In order however that the exclusion of gifts from the ED base except those made within the stipulated period does not facilitate avoidance, certain provisions were incorporated in the ED Act right from the beginning whereby gifts which are not bonafide or which entail some reservation of interest by the deceased are deemed to pass on the death of the transferor. Among the provisions in the ED Act which so authorise the inclusion of assets of which the title did not belong to the deceased at the time of death in order to counter avoidance through inter vivos transfers, the notable ones are sections 10, 11, and 12.

Section 11 applies where the property in which an interest limited to cease on death was disposed of or determined before death but such disposition was made within a period of two years prior to death (six months in the case of dispositions in favour of charities). Section 12 deals with property comprised in a settlement made by the deceased reserving for himself for life any interest in the settled property or a right to regain the trust fund, while section 10 is meant to bring within the tax base all gifts whenever made, where the disposition was not bonafide or any interest was retained by the deceased in the property either in law or in fact.

While all the three sections apply to dispositions of property or interest therein made during one's life-time, the ambit of section 10 is wider than that of the other two in that, unlike section 11, it applies to the disposition of any property or interest in property and not just interest limited to cease on death and, unlike section 12, its application turns not merely on the reservation of any enforceable right by the donor in the gifted property but also on the physical exclusion of the donor from the enjoyment of the property at least for the critical period. The intention underlying section 10 obviously is to defeat avoidance of ED through the device of sham or ineffectual gifts. The section however has lost much of its efficacy through judicial rulings and also through subsequent amendments in the law.

Framed on the lines of a similar provision in the now defunct death duty law of UK, section 10 of the Indian ED Act was initially given a fairly strict interpretation by the Supreme Court (SC) in India as by the Privy Council in UK In the leading case on the subject, a decedent had transferred a house property to his sons more than two years before his death without reserving any right or interest enforceable in law but continued to reside in it till his death. The SC ruled that the property passed on the death of the transferor because of the fact that he was not actually excluded from the use of the property. The conditions stipulated in the section were analysed by the SC in this context with the following observations:

> "The crux of the section lies in two parts: (1) thd donor must bonafide have assumed possession and enjoyment of the property,

> which is the subject matter of the gift, to the exclusion of the donor immediately upon the gift, and (2) the donee must have retained such possession and enjoyment of the property to the entire exclusion of the donor or of any benefit to him by contract or otherwise. The second part of the section has two limbs: the deceased must be entirely excluded (i) from the property, and (ii) from any benefit by contract or otherwise."
> (George Da Costa v. CED)

It follows that section 10 comes into operation if any one of the conditions is violated. In Da Costa's case the SC held that section 10 was applicable as the conditions laid down in the first limb of the second part were not satisfied.

The SC also laid down certain propositions for testing whether the conditions enjoined by the different parts as well as limbs of section 10 are satisfied or not. The term "possession" contemplated in the expression "possession and enjoyment" need not be actual physical possession but would include constructive possession (e.g., receipt of rent from the property), that is, such possession as the nature and circumstance of the property would allow. It was also held that the words "by contract or otherwise" in the second limb of the second part would not control the words "to the entire exclusion of the donor" in the first limb. In other words, in order to invoke the section it was not necessary that the possession of the donor of the property must be referable to some contractual or other arrangement enforceable in law or in equity.

It was also made clear by the SC that the fact that constructive possession of the property remained with the donee would not satisfy the first limb of the second part if the donor happened to be in physical enjoyment or use of the property. In such a case possession by the donor would not be incompatible with that by the donee. As regards the second limb of the second part, the court made it clear that the expression "by contract or otherwise" appearing in the section must be construed *ejusdem generis* so that the word "otherwise" must mean some kind of legal obligation or some transaction enforceable in law or in equity which may confer benefit upon the deceased. For testing whether the deceased had been excluded from possession, the question of reservation of any legally enforceable right was irrelevant.

Even though the section under review was given a strict interpretation in the case mentioned above by the highest judicial authority of the country, several factors have undermined its potency over the years. The main factors which have tended to weaken its efficacy are briefly enumerated below.

(i) Although it is virtually a reproduction of the corresponding provision of the UK Finance Act of 1894, right from its inception the scope of the section in the Indian law has been narrower than it was in the UK law. While referring to "property taken under any gift", section 10 of the Indian ED Act provides that such property shall be deemed to pass "to the extent" that bona fide possession and enjoyment was not immediately assumed by the donee and thenceforward retained to the entire

exclusion of the donor or of any benefit to him by contract or otherwise. The incorporation of the qualifying expression "to the extent" constituted a departure from the corresponding provisions of the UK and Australian statutes. Of course, the courts here have held that if the property in respect of which the donor has not been excluded is not specified or defined or otherwise indicated with precision so that it cannot be predicated to which particular part of the gifted property the infringement of the conditions (e.g., reservation or use by the deceased) related, the entire property would be deemed to pass (Reshmohan Chatterjee v. CED; CED v. Parvati Ammal). Nevertheless the words "to the extent" act as a constraint on the ambit of the provision in the Indian law.

(ii) Despite the SC's ruling in Da Costa's case, some High Courts have taken the view that continued residence of the donor in a property given away to a spouse will not suffice to justify the application of section 10 on the ground that such an interpretation would go against public policy. The reasoning advanced for this view is that:

> "No construction should be put on the Estate Duty Act so as to be against the public policy to the extent that wherever a husband makes a gift of a property to his wife he should lose both the property and The wife". (Shamsun Mansur v. CED).

This view was subsequently upheld by the SC in another case (CED v. Umesh Rudra).

(iii) In a series of cases the SC has held that transfer of monies by book entry in the account of a firm will not attract section 10 even if the transferor continues to be a partner in it after such transfer is made. In a case where gifts were made by book entry by the deceased who happened to be a partner in the firm to his sons and daughter who too were partners in the firm and the amounts remained with the firm till his death, SC negatived the application of section 10 (CED v. N.R.Ramaratnam). In another similar case where the proprietor of a business transferred monies to his sons by book entry and later took them in as partners, the application of section 10 was barred (CED v. R.V. Viswanathan). In a case decided earlier SC had held that section 10 is not applicable where the deceased let out a property to a firm in which he was a partner and the house was given away to his two sons, and the firm paid rent to the donees. The deceased had also given monies to his sons by book entries. Neither the value of the house nor the gift of the monies could be brought under the charge of ED by invoking section 10 (CED v. C.R. Ramachandra Gounder).

The decisions cited above diverge from the decision of the Privy Council in the celebrated case of Clifford John Chick v. Commissioner of Stamp Duties where, under essentially similar circumstances, application of provisions analogous to section 10 was upheld. The SC in India drew a distinction between John Chick's case and the cases which went upto it (referred to above) by arguing that section 10 will apply only where the possession and enjoyment of the transferred asset is related to the asset itself but would have no application where the possession and enjoyment is derived from something outside

it such a partnership right. Explaining the principles to be followed in deciding such cases, the SC has observed in a recent case:

> "When a property is gifted by a donor the possession and enjoyment of which is allowed to a partnership firm in which the donor is a partner, when the mere fact of the donor sharing the enjoyment or the benefit in the property is not sufficient for the application of section 10 of the Act until and unless such enjoyment or benefit is clearly referable to the gift, i.e., to the parting with such a enjoyment or benefit by the donee or permitting the donor to share them out of the bundle of rights gifted in the property."
> (CED v. Kamlavati)

Even with the clarification given by the SC reproduced above, one cannot help feeling that the distinction sought to be drawn is somewhat hair-splitting and is not based on any difference of substance. In sum, the requirement of total physical exclusion of the donor from a transferred asset to avoid estate taxation has been reduced virtually to a nullity in the case of transfers of several important categories. Its scope has also been limited quite considerably by the introduction of the second proviso and also by the exemption granted under section 33(1)(O) for gifts to relatives of specified categories.

(iv) Contrary to the view taken by judicial authorities in UK, courts in India have held that "the benefit by contract or otherwise" occurring in the section must be referable to the property gifted. It was settled law in England when the death duties were abolished, that for the corresponding provision of the death duty laws to be attracted, it was not imperative that the benefit should have been reserved in the gifted property itself. It would be enough if the benefit was reserved as a part

of the transaction relating to the gift. Thus, where in consideration of a gift of a sum of money the donee convenanted to pay an annuity to the donor, a benefit was held to have been reserved (A.G. v. Worrall; St. Aubyn v. AG). It was assumed that the same principle would apply in India and was in fact applied by some High Courts (e.g., in S. Khatoon v. CED, K. Samsuddin v. CED) until the SC ruled otherwise. In the case which went up in appeal the SC held that the benefit must be charged upon the properties gifted (CED v. Kanakasabai).

(v) The section has lost much of its teeth and in fact its relevance after the amendments made in the ED Act in 1965. One of the amendments (inserting a new proviso to section 10) provided that a house property (of part thereof) given by a decedent to a spouse, son, daughter, brother or sister shall not be deemed to pass on his death by reason only of his residence therein. Under the other provision introduced in 1965 [section 33(1)(o)] property given away to a spouse, son, daughter, brother or sister beyond a period of five years before death shall not be taxed to ED, it is chargeable under the GT Act. Therefore, the present position is that gifts to relatives of the specified category are not dutiable if made beyond five years before death irrespective of whether the donor reserved any right or continued to be in possession of the object of the gift or not. By virtue of the amendment to section 10, in the case of the gift of a house made to any such relative within the critical period of five years, duty will not be chargeable merely by reason of residence. That is to say, in such a case the property will be deemed to pass only if the gift happens to fall within a period of two years before death.

It may thus be seen that section 10 now applies mainly to gifts made to persons outside the specified relationship with the decedent. Where gift tax is chargeable, gifts to specified category of relatives are not includible if made beyond five years before death. House property given away to such relatives within five years but beyond two years before death is also not liable to ED unless there is some reservation by the donor or the deceased continues to enjoy it even after making the gift but not merely because of residence.

(vi) Although section 10 can be applied where any beneficial interest is reserved in property settled on a religious trust (debuttar property), in the case of a wakf the section is of no help. Even in the case of a Shebait of a Hindu religious trust, the section may not be of any avail if it can be shown that the benefit was reserved only in the exercise of the office of a trustee as for example in the case of Satyanarayan Bagla v. CED.

DISCRETIONARY TRUST AS A MEDIUM FOR AVOIDANCE OF ESTATE DUTY

A trust is an obligation annexed to the ownership of property, arising out of confidence reposed in and accepted by the owner for the benefit of another or others and of another and the owner himself. A trust is created when the author of the trust indicates with reasonable certainty his intention to create a trust accompanied by, except in the case of a will or where he constitutes himself the trustee, complete divestment of ownership in favour of the trustees, the purpose of the trust, the beneficiaries and the trust property. Other than in the case of a testamentary trust, no deed is essential for setting up a trust except where the subject matter is immovable property.

Depending upon the composition of the beneficiaries, a trust can be public or private. A private trust falls under two categories, namely, absolute or specific and discretionary. In an absolute or specific trust, the beneficiaries and their specific shares in the income or property of the trust are determinate, while in a discretionary trust the income of the trust fund can be allocated among the beneficiaries at the discretion of the trustees. A discretionary trust can be exhaustive or non-exhaustive. It is exhaustive where the trustees are required to distribute the whole of the income of the trust. It is non-exhaustive where the trustees are given the discretion not to apply the whole of the income for the benefit of the discretionary beneficiaries but to accumulate the portion not so paid or applied.

In a sense, creation of a trust amounts to transfer of property and therefore attracts the gift tax. Where the share of the beneficiaries is specified, on the death of anyone of them the interest ceasing on death attracts estate duty. Even though ownership does not change, duty is charged whenever there is a change of beneficial ownership. The problem arises where the trusts are discretionary. For on the death of a beneficiary of such a trust, it is not possible to ascertain the value of the interest ceasing on death. Apart from the facility of income and wealth splitting, a discretionary trust makes it virtually impossible to apply the ED taxes in the event of any death among the beneficiaries.

Under the scheme of Indian Estate Duty Act cesser of interest including interest in trust income is deemed to be property passing on death liable to be taxed and such interest is valued on a pro rata basis with reference to the aggregate value of the properties of the trust. The absence of any provision to tax cesser of interest led to the practice of anti-generation-skipping transfers in the USA. The enactment of the generation-skipping transfer tax in 1976 was designed to counter this practice. Such generation-skipping was not possible in India as interest ceasing on death has been taxed to estate duty right from the inception. Settlements where the settler reserved any interest are also deemed to pass on death unless the interest is surrendered well before critical period of two years. It is the death of a beneficiary of a discretionary trust which does not give rise to any quantifiable devolution of property which can be subjected to the estate duty. The advantages of a discretionary trust are:

(i) If the settlor has survived the statutory period of two years he can produce a situation where the assets neither belong to him nor to the beneficiaries. They will belong to the trustee who holds them in a fiduciary capacity and, since he does not have any beneficial interest, there is no passing of property on his death.

(ii) Provided there are at least three beneficiaries, no estate duty is attracted upon the death of any of them, the reason for this exemption being that every beneficiary's interest is dependent upon the exercise of the trustee's discretion in his or her favour. Duty will, of course, become payable on the death of the last but one beneficiary, when the estate passes absolutely to the survivor or what remains then of the property, i.e., when there is actual distribution of capital. In order to prevent the beneficiaries of a discretionary trust falling below two and thereby postpone the day of doom, an attempt is made to include as many living members of the family as possible as beneficiaries.

Where a discretionary trust is created through a will, on the death of the settlor the property passes under the general provision of the ED Act, namely, section 5. Similar is the position where a discretionary trust comes to an end following a death. Where the trustees of a discretionary trust are required to follow the instructions of the settlor from time to time, the entire trust property passes on the settlor's death. Where the settlor is also one of the objects of the trust, it has been held that it amounts to reservation of interest and comes within the ambit of the anti-avoidance provisions

of section 12 of the ED Act. Where the shares are clearly defined, mere discretion on the part of the trustees to apply the income for the benefit of a beneficiary will not be enough to defeat levy of duty (SC in Mahendra Rambhai Patel). In other words, a discretionary trust does not come into being unless there is complete discretion to the trustee in the matter of timing and distribution of the benefits.

Despite the restrictions imposed in the law, with a little thought and caution, a person can so arrange his affairs through the medium of a discretionary trust that he can avoid or reduce the payment of estate duty. To tackle the problem, some fairly sweeping measures were taken in UK in 1969 whereby it was provided that upon the death of any one beneficiary, a proportion of the corpus equal to the proportion of income that has in fact been paid to the beneficiary over the years will be brought under taxation in the same way as interests in possession. With the introduction of the CTT, an entirely new scheme of taxation of property settled on discretionary trust has been introduced in which the focal point of charge is the occasion of a capital distribution out of the settled property. Scope of the charge was extended by certain deeming provisions under which capital is deemed to have been distributed on certain occasions.

In India, discretionary trusts have been the subject of legislative attention in recent years. The income of a trust is taxed at a flat rate of 65 per cent if the shares of the beneficiaries are unknown or indeterminate. Similarly, the wealth of such trusts is taxable at the rate of 3 per cent or at the appropriate rate

applicable if such assets are held by a resident citizen of India, whichever is more beneficial to revenue. It may thus be seen that discretionary trusts cannot avoid taxation altogether and, therefore, the kind of measures taken under the CTT in UK or under the anti-generation-skipping transfer tax in USA may not be called for here. However, there are certain exceptions from the application of the flat rates of income tax and wealth tax in the case of certain categories of discretionary trust which open up scope for avoidance. For instance, the flat rate of 3 per cent wealth tax is not applicable in the following cases:

(a) Where the trust has been declared by a person by will and such trust is the only trust so declared by him.

(b) Where none of the beneficiaries has net wealth exceeding the amount not chargeable to wealth tax or is a beneficiary under any other trust.

(c) Where the assets are held under a trust bona fide created by a non-testamentary instrument before March 1, 1970 exclusively for the benefit of the dependent relatives of the settlor.

(d) Where the trust is created bona fide for the benefit of persons employed in business/profession of the assessee.

Hence, it seems necessary to ensure that properties settled on a discretionary trust are also subjected to some tax when a beneficiary dies.

One way of ensuring this would be to formulate a scheme whereby a discretionary trust created by inter vivos transfer will attract the usual gift tax. Where the trust comes into existence after the death of the settlor, tax will be charged on the property in full. When a beneficiary dies, a fraction of the trust property may be brought under charge taking the share of all beneficiaries to be equal unless specified otherwise. Alternatively, the property of the trust may be subjected to periodic tax of say 25 per cent every 10 years as under the CTT of the UK[1/].

1/ For a detailed outline of a scheme counter avoidance through the medium of discretionary trusts see Goodhart, W. (1980).

Extracts from Full Report of the Taxation Review Committee, Government of Australia (1975)

CHAPTER 24: APPENDIX C

SITUS OF ASSETS

24.C1. The common law has various technical rules for determining the situs of an item of property. These rules are based largely on considerations of convenience. Some Australian taxing legislation has relied exclusively on the common law rules: the present Estate Duty Assessment Act, for example, contains no rules as to the situs of assets. Other Australian taxing legislation has modified the common law rules to some extent by introducing rules applying in particular situations: section 13 of the Gift Duty Assessment Act contains a number of rules of this sort.

24.C2. In the Committee's view the common law rules are not always appropriate in this context: in certain areas, including speciality debts and interests in trust estates, they have been used in the past to avoid tax. The modifications to the common law rules in the Gift Duty Assessment Act are inadequate in some instances and go too far in others. For example, the Act ignores the problem of determining the situs of a trust estate, yet treats shares in a company incorporated outside Australia as being situated in this country if the shares are listed on a branch register of a company in Australia. Shares in a company incorporated in Australia should be taxable under Australian law irrespective of where the register on which the shares are listed is kept, since the company is substantially dependent on Australian law for its existence

and continuance. For the same reason, shares in a company incorporated outside Australia should not be treated as being situated in this country even where they are listed on a register in Australia. In the case of a trust estate, the common law rules, which depend on how far the administration of the trust estate has proceeded, should not be followed. An interest in a trust estate, fully administered or otherwise, ought to be treated as situated in Australia only in so far as any of the assets of the trust estate are, on the relevant date, situated in Australia. In determining the extent of the Australian assets, those liabilities of the trust estate not charged against particular assets should be apportioned over all the assets. The Committee can see no justification for imposing a tax on an asset merely because one or more of the trustees reside in Australia or for making the liability for tax depend on whether or not a trust estate has been fully administered.

24.C3. The rules contained in Article III of the estate duty convention between the United States and Australia provide a reasonable balance. The Committee therefore proposes the following rules, based on that convention:

(a) Immovable property (held otherwise than by way of security) should be deemed to be situated at the place where the land concerned is located.

(b) Tangible movable property (held otherwise than by way of security and other than property for which specific provision is made) and bank or currency notes and other forms of currency recognised as legal tender

at the place of issue should be deemed to be situated at the place where that property or currency is located, or, if in transitu, at the place of destination.

(c) Debts (including bonds other than those referred to in (d), bills of exchange and promissory notes, whether negotiable or not), secured or unsecured and whether under seal or not, excluding the forms of indebtedness for which specific provision is made elsewhere in these recommendations, should be deemed to be situated at the place where the debtor is resident. However, if the debtor, at the time when the debt is to be valued has an established place of business in the country in which the owner of the debt was domiciled and the debts were incurred in carrying on the business of that establishment, the debts so incurred should be deemed to be situated in that country.

(d) Bonds, stocks, debentures, and other debts being securities, issued by any government, municipality or public authority should be deemed to be situated at the place where that government, municipality or public authority is located.

(e) Bank accounts should be deemed to be situated at the place where the bank or branch thereof, at which the account was kept, is located.

(f) Moneys, payable under a policy of insurance or under an annuity contract, whether under seal or not, should be deemed to be situated where the policy or annuity contract provides that the moneys are payable; or, if the policy or annuity contract does not provide where the moneys are payable:

(i) at the place of incorporation, in the case of a company; or

(ii) at the place of residence of the person by whom the moneys are payable, in any other case.

(g) A partnership should be deemed to be situated at the place where the business of the partnership is carried on, but only to the extent of the partnership business at that place.

(h) Ships and aircraft and shares thereof should be deemed to be situated at the place of registration of the ship or aircraft.

(i) Goodwill as a trade, business or professional asset should be deemed to be situated at the place where the trade, business or profession to which it pertains is carried on

(j) Patents, trade-marks and designs should be deemed to be situated at the place where they are registered.

(k) Copyright, franchises, and rights or licences to use any copyrighted material, patent, trade-mark or design should be deemed to be situated at the place where the rights arising therefrom are exercisable.

(l) Rights or causes of action ex delicto surviving for the benefit of an estate of a deceased person should be deemed to be situated at the place where such rights or causes of action arose.

(m) Judgment debts should be deemed to be situated at the place where the judgment is obtained.

(n) Shares in a company should be deemed to be situated at the place where the company is incorporated.

(o) An interest in a trust estate, whether fully administered or otherwise, should be deemed to be situated in Australia only in so far as any of the trust assets are situated in Australia; provided that the liabilities of the trust estate which are not charged against any particular asset may, if the trustee so elects, be apportioned between the Australian and ex-Australian assets on the basis of their respective values but, if the trustee does not so elect, shall be treated as being charged against the ex-Australian assets.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Part I

1. The contribution of the estate duty (ED) and the gift tax (GT) to the tax revenue of the Government is not only small - it never exceeded 0.5 per cent of the gross tax revenue of the Centre (i.e., before sharing with the States) - the share of the two taxes together in the tax revenues of the Centre has declined steadily over the last two decades.

2. During the period 1960-61 to 1979-80 revenue from the ED grew at the rate of 7.5 per cent per annum and that from the ED and the GT taken together at the rate of 8.5 per cent per annum as against a growth rate of about 14 per cent in the gross tax revenue of the Centre. The revenue from the WT and stamps and registration grew at a faster rate (13 per cent and 11.6 per cent respectively) than that from the ED and GT but the growth of the tax revenue of the Centre and the States taken together has been even faster (14.3 per cent).

3. While there has been some growth in the yield of the ED at current prices - though at a much lower rate than that of the total tax revenue of the Government - in real terms the growth has been virtually insignificant. At 1960-61 prices the total revenue from the ED and the GT increased from Rs 4 crore in 1960-61 to Rs 7 crore in 1979-80.

4. As a revenue source, the ED has not been very responsive to increase in the GDP. The buoyancy of revenue from ED with respect to GDP works out to 0.677 for the period 1960-80. If allowance is made for the impact of

the discretionary changes made during the period the elasticity of the ED might turn out to be greater than its buoyancy but is unlikely to be greater than 1.

5. The elasticity of revenue from the ED would be less than unity also with respect to the rate of growth of capital in the country or the rate of appreciation of the value of assets, particularly, real estates.

6. There has been a trend towards a fall in the share of estates of Rs 5 lakh and above in the total assessed value of estates coming under the ED. In the wealth tax assessments the proportion of tax-payers worth Rs 5 lakh or more also appears to have decreased but their share in the net wealth assessed has not registered a commensurate decline. This indicates a trend towards lessening of concentration in inherited wealth in which ED may have played a part.

7. The growth of ED demand raised during the period 1970-71 to 1981-82 works out to 4.6 per cent per annum while that of collections comes to 6.9 per cent. The elasticity of collections with respect to demand works out to 1.47. The low yield of the ED cannot, therefore, be attributed to any serious drag in collection. The causes of low yield have, therefore, to be looked for on the side of demand rather than collections.

8. A comparison of the figures of ED assessments with those of WT suggests that there may be leakages particularly in the upper value brackets, affecting the growth of the base of the ED either through avoidance or evasion.

9. The possibility of evasion cannot be ruled out specially with the increase in the maximum marginal rate from 40 to 85 per cent since the mid-1960s. Along with inflation the increase in the rates casts a heavy burden on the legatees of large estates which cannot but accentuate the tendency to evade.

10. The average assessed value of estates has registered a decline in recent years. While the average value was around 1.72 lakh in 1960-61 and 1.82 lakh in 1961-62, it stood at Rs 1.61 lakh in 1978-79 and Rs 1.68 lakh in 1979-80. Decline in the mortality rates may have led to a fall in the aggregate value of the estates coming within the purview of the ED annually but does not explain the decline in the average assessed value of the estates.

11. Valuation constitutes the central problem in ED assessment. Sample survey has shown that as much as 70 per cent of the variations between returned and assessed PV are accounted for by differences in the valuation of movable and immovable assets.

12. The slow growth of the base of the ED is partly attributable also to the weaknesses in the administration. The ED Act is a notoriously complicated piece of legislation. This, together with the absence of any time limit on the completion of the assessment results in delays in the completion of assessment of large estates which sometimes drags on for more than 10 years. A review of a few sample cases showed that formidable problems are sometimes encountered in the assessment of large estates and the difficulties are often compounded by disputes amongst accountable persons for the duty, court orders regarding titles to certain properties and so on.

13. The cost of administration of ED Act is quite high relatively to that of other taxes. With the slow growth of collections the proportion of cost of administration to revenue from the ED is steadily going up, and now stands at 7-8 per cent as compared to about 3 per cent for income tax.

14. The cost of compliance seems to be quite high. Over 75 per cent of the dutiable cases is handled by lawyers. Even for obtaining an exemption certificate, the APs find it necessary to engage representatives in about 25 per cent of the cases.

15. There is not much substance in the commonly held belief that heirs of persons of small means are subjected to delay and harrassment in the matter of obtaining clearance certificates. The broad picture which emerges from a sample survey undertaken for this study is that, while there is some delay in a few cases (5 per cent), clearance is given by and large within a month or so.

16. In order to remove the hardships of heirs of small estates comprising balances to provident/ superannuation funds, etc., a simplification of the relevant law and rules is needed so that the trustees of these funds are absolved of all responsibilities while releasing balances not exceeding a certain limit.

Part II

1. Considerations of equity and the objective of reduction of inequalities call for taxation of capital in some form.

2. The case for taxing wealth on an annual basis is not as persuasive as is sometimes made out on "reserve power" and efficiency grounds. The balance of considerations suggests that the tax on capital should be designed to tax transfers of wealth rather than ownership as such. Nevertheless, an annual wealth tax is useful as an instrument of control and as a device for correcting some of the deficiencies of income tax but the rates of such a tax should be kept low.

3. There is no strong case for exempting capital gains completely from taxation even when there is an annual wealth tax. But there should be some co-ordination between the capital gains tax and other transfer taxes.

4. A tax on bequests cannot be effective unless there is a tax on gifts inter vivos and integration between the two, either partial or full, depending upon the circumstances and balance of relevant considerations.

5. Integration at the level of the donor (estate duty, capital transfer tax etc.) is preferable to integration at the level of the donee (AT)from considerations of facility of administration, potency in reducing inequality and capacity to raise revenue. Equity can be taken care of through appropriate exemptions and reliefs for transfers to spouse and children.

6. In India, administrative considerations rule out the introduction of any donee-based tax in place of the ED since ED has been in operation for nearly 30 years now and interpretation of many of its provisions is well settled. To keep the task within manageable limits, cumulation of and integration with gifts inter vivos can be limited to such gifts made over a period of ten years or at least seven years before death.

7. The principle of taxation of property once a generation demands that transfers between spouses should be ignored.

8. If total exemption for interspousal transfer is considered undesirable and the scheme of integration proposed earlier is accepted, exemption upto a limit of Rs. 3 lakh may be allowed for estates passing between spouses, together with simultaneous deletion of the provision for exemption of one house property upto a value of Rs 1 lakh for ED purposes. The idea of exempting one residential house as such violates both horizontal and vertical equity. If at all, exemption for a residential house should be restricted to a specified covered area or "living space". In any case, an overall ceiling on exemption should be laid down. There is need for a ceiling in view of the widespread practice of evasion through "benami" holding of property.

9. Concession may be given for minor children in the form of an additional allowance of Rs 3000 per minor child per year till the age of maturity subject to a ceiling of Rs 50,000 per child.

10. In the context of the proposed spouse and minor children's allowances, there is no need to raise the recently introduced exemption limit of Rs 1,50,000.

11. Both the threshold level and the various exemption limits should be periodically revised to take account of inflation. All valuations should however be made at prevailing market rates.

12. Section 10 now applies to a very narrow category of transfers, viz., those falling beyond two years but not more than five years. Its provisions should be tightened up to remove the observed weaknesses. The tests of genuineness of inter vivos transfers as laid down in Sections 10 and 12 should be retained and the provisions of sec. 33 (1) (c) removed.

13. Erosion of the tax base through the device of generation skipping discretionary trusts should be plugged either by taxing the properties of a discretionary trust at the rate of 25 per cent every ten years or by imputing equal share to all beneficiaries in the assets of the trust.

14. (i) The permissible period of reopening an ED case may be extended in the case of concealment from the existing 3 years to 8 years where the value of concealed assets exceeds Rs 1,00,000.

(ii) The provisions relating to penalty should be amended to cast a joint and several liability to make a true statement of all dutiable assets left by a decedent. The ED account should either be verified by all major legatees or account should be submitted separately by each.

(iii) Provisions similar to those in the IT Act should be incorporated authorising prosecution for concealment and other serious offences.

(iv) Claims to title to property, standing in the name of a benamidar, by legatees of a deceased person on grounds of succession should be forbidden unless the property is included in the ED Account.

15. In the context of the recommendation for partial unification of estates and gifts over 7 to 10 years and exemption of interspousal transfers upto Rs 3 lakh, the provisions relating to separate estates [Section 34 (3)] may be deleted.

16. The proposal for excluding agricultural lands from the purview of the ED requires reconsideration.

17. To avoid disputes and prevent revenue loss a definition of agricultural land similar to that contained in Section 2(14) (iii) of the IT Act 1961 should be incorporated in the ED Act also.

18. The operation of the Mitaksara law of inheritance creates an acute inequity in the incidence of estate duty between different schools of Hindu Law and other communities besides acting as a serious constraint on the efficacy of ED as on equaliser of inherited wealth. One solution could be to put the deceased coparcenar's interest on the top slabs of the principal value while determining the tax payable.

19. If the tax is to fall equally on estates of equal size, there is no reason in equity for excluding foreign assets, whether movable or immovable, from the PV at least for determining the rate of duty on assets situated in India.

20. Following the decision of the Madras High Court in the case of CED vs. Dr. Ida Bella Scudder, there is need for review of the concept of 'domicile'. Suitable provision may be made in the ED Act for determination of domicile on the basis of the length of stay in the country as in UK under the CIT.

21. With the exemption now available for one residential house the provision for a separate exemption [Sec 33(1)(1)] for residential buildings of former rulers may be deleted.

22. With the proposed integration of gifts and bequests the exemption for gifts for marriage made within the critical period now allowed under the GT Act [Sec 5(1)(vii) of the GT Act] may be integrated with exemption for the same purpose in the ED Act [Sec 33(1)(k) of the ED Act] and a limit of Rs 30,000 for GT and ED taken together may be fixed. For gifts made beyond the critical period the exemption for marriage and normal expenditure now available under the GT Act may continue as also for gifts to meet normal expenditure upto a maximum of Rs 5,000 a year per each dependent child.

23. With the proposed integration of gifts and bequests the exemption of gifts of policies of insurance [Sec 33(1)(k)] may be withdrawn.

24. Household goods except identifiable consumer durables of more than a certain value, say, Rs 3,000, should be excluded from the PV.

25. The exemption of monies covered by insurance policies assigned for payment of ED and/or deposits towards payments of estate duty to the extent of duty payable or Rs 50,000 whichever is lower [sec. 33 (1)(f)] should be withdrawn. Similarly, the exemption of amounts received from life insurance policies after death to the extent of Rs 5,000 [sec 33(1)(h)] should also be withdrawn.

26. The provision for granting relief, in certain circumstances, from ED payable for tax on capital gains on sale of assets within a period of two years after death (sec 50B) should be restricted to the estate duty charged on the accrued capital gains from the asset. Further, the relief should be provided in capital gains tax rather than in ED by calculating the ED paid on the accrued capital gains as on the date of death.

27. For achieving the basic objectives of the ED, valuation for ED should be as close as possible to the market value except where a concession is given specifically. Such exemptions are better given by raising the exemption limit suitably instead of keeping down the valuation.

28. Valuation of assets for ED has fallen far behind their market value. Underreporting of true values in transfer deeds has compounded the problems of valuation. While the problem does not admit of easy solution, improvement can be achieved if information regarding transaction in properties is collected in a systematic manner in the ED

offices. Reliable information regarding property transactions can be obtained at least in the case of transactions entered into by government or semi-government organisations.

29. The system of having valuations certified by approved valuers does not seem to be working well. A provision for reference to valuation officers as under the WT and IT Acts may be incorporated in the ED Act.

30. Valuation of equity shares should be based as far as possible on their market value. In the case of unquoted shares valuation should be based on the market value of the assets. This method has been approved by judicial authority in the context of the GT.

31. On the death of a partner in a partnership firm, the true value of the deceased's share should be properly assessed irrespective of any stipulation in the partnership deed, and after taking account of all assets of the firm including goodwill.

32. The provisions for inclusion of the value of assets transferred to controlled companies (sec.17) in proportion to the benefits derived may be deleted.

33. Despite their restrictive conditions the sections governing deductions of debts under the ED Act in India (Sec. 44 to 47) are a little too liberal and need to be tightened up. In particular, the provisions regarding allowance of foreign debts also need to be tightened up to ensure that such debts are first set off against movable properties abroad, then foreign immovable properties and then against dutiable assets.

34. If the disposal of pending cases is to be speeded up some experienced officers should be spared from routine work and allowed to concentrate only on such cases without any pressure for numbers. The system of assigning the jurisdiction over cases involving PV exceeding a certain value (Rs 20 lakh and over) to the Deputy Controller may be revived.

35. The ED Act is a notoriously complex piece of legislation and its administration requires knowledge of laws not only of ED but also of several other areas like succession, transfer of property, Hindu Law, etc., as also investigative skill of a high order. Officers working in ED circles deserve special pay more than perhaps any other circle in the IT Department.

36. In order to prevent accumulation of arrears, it is necessary to lay down some time limit for completion of assessments. Having regard to the desirability of completing ED assessments only after completing all pending IT and WT assessments, period of limitation for completing an ED assessment should be linked to the assessments under the IT and WT Acts.

37. The system of reporting deaths to the ED offices needs to be improved. The sample survey in selected centres made for this study shows that there is no uniformity in the matter of reporting deaths and Assistant Controllers rely almost wholly on voluntary compliance by APs. Some arrangements may be evolved by which authorities under the State governments are statutorily made responsible to intimate information regarding deaths to the nearest ACED.

38. The requirement for the swearing of the ED return before a magistrate or a notary may be dispensed with. This would not stand in the way of prosecution or other penal measures for offences.

39. The procedure for granting relief for quick succession may be simplified by doing away with the need for Board's approval. Quick succession relief should be based in the light of the spirit of the provision without insisting on a narrow legalistic interpretation.

40. The ED Act does not require the ACED to issue any notice for submission of an account to the AP before resorting to ex-parte assessment. The lacunae may be remedied by a suitable provision in the law.

41. Unlike in the IT Act there is no provision in the ED Act for reopening an ex-parte assessment. Suitable provision should be incorporated in the ED Act for reopening an ex-parte assessment in appropriate cases.

42. There should be a provision in the ED Act for charging interest for late filing of return and/or non-payment of duty with statutory powers to the controller to waive the interest in appropriate cases on the basis of guidelines to be laid down by the Board.

43. Provisions similar to sections 263 and 264 of the IT Act should be incorporated in the ED Act to provide relief to APs and also safeguard revenue.

44. The recovery procedure followed in the other direct taxes should be made applicable to arrears under the ED also.

45. In the interests of revenue and also uniformity and equity all payments actually received from the employer by the heirs of a deceased employee should be deemed to pass on death in the same way as proceeds of insurance policies regardless of whether the deceased had any vested right therein or not, except in the case of death by accident on duty.

46. Premia paid on policies taken under the Married Women's Property Act should be deemed to be gifts inter-vivos.

47. A provision similar to that in the other direct taxes should be introduced in the ED Act authorising the ACED to refuse refund of the duty, pending decision in a Departmental appeal, where the Assistant Controller has reasons to believe that such refund may be prejudicial to revenue. Interest should be paid on delayed refunds.

48. It should be clarified that ED is not deductible as a liability from the PV.

49. It should be made clear too that the recent amendment of the ED Act making Rule 18B of the WT Rules applicable to the valuation of one residential property will apply only where the property is self-occupied.

50. As recommended by the Chokshi Committee, the device of postponing ED through the method of "grafting" in the light of the decision of the House of Lords in UK should be plugged by suitable amendment of section 11.

51. Sections 8, 25 and 29 of the ED Act will become redundant if the recommendations made here are implemented and may be deleted.

52. Full exemption should be allowed for bequests to public charity.

53. One High Court has held that the provision authorising the assessment of interest ceasing on death, i.e., section 7 read with Rule 40 will have no application unless the deceased had some monetary benefits. This can be a source of base erosion. It should be provided that accrual of any benefit will bring the section into operation and the benefit can be valued at the current market rate.

CITATIONS

1. Controller of Estate Duty, Lucknow v. Alok Mitra (1980) 126 ITR 599.

2. George Da Costa v. Controller of Estate Duty, Mysore (1967) 63 ITR 497.

3. Rash Mohan Chatterjee v. Controller of Estate Duty, West Bengal (1964) 52 ITR (ED) 1.

4. Controller of Estate Duty, Madras v. Parvati Ammal (1974) 97 ITR 621.

5. Shamsun Mansur v. Controller of Estate Duty, West Bengal (1969) 71 ITR 301.

6. Controller of Estate Duty, Karnataka v. Umesh Rudra (1979) 117 ITR 579.

7. Controller of Estate Duty, Madras v. N.R. Ramaratnam (1973) 91 ITR 1.

8. Controller of Estate Duty, Kerala v. R.V. Viswanathan and Others (1976) 105 ITR 653.

9. Controller of Estate Duty, Madras v. Ramachandra Gounder (1973) 88 ITR 448.

10. Chick v. Commissioner of Stamp Duties of New South Wales (1958) 2 All ER 623; (1959) 37 ITR (ED) 89.

11. Controller of Estate Duty, Punjab, Haryana, J.&K, H.P. and Chandigarh v. Kamlavati (1976) 120 ITR 456.

12. Attorney-General v. Worral (1895) 1 QB 99.

13. St. Aubyn v. Attorney-General (No. 2) (1952) A.C. 15.

14. Sarwari Khatoon v. Controller of Estate Duty, Lucknow (1970) 78 ITR 719.

15. Kikabhai Samsuddin v. Controller of Estate Duty, Gujarat (1969) 73 ITR 241.

16. Controller of Estate Duty, Madras v. Kanakasabai (1973) 89 ITR 251.

17. Sathyanarayan Bagla v. Controller of Estate Duty, West Bengal (1982) 133 ITR 710.

18. Mahendra Rambhai Patel v. Controller of Estate Duty, Gujarat (1967) 63 ITR 645.

19. Sarojini Devi v. Sri Kristna (1944) AIR 1944 Mad. 401.

20. Controller of Estate Duty, Kerala v. V. Venugopala Verma Rajah (1976) 105 ITR 593.

21. Commissioner of Wealth-tax, Andhra Pradesh v. Officer-in-charge (Court of Wards), Paigah (1976) 105 ITR 133.

22. Second Gift Tax Officer, Mangalore v. D.H. Nazareth (1970) 76 ITR 713.

23. Controller of Estate Duty, Madras v. Alladi Kuppuswamy (1977) 108 ITR 439.

24. Controller of Estate Duty, Madras v. Dr. Ida Bella Scuddar (1980) 123 ITR 104.

25. Controller of Estate Duty, West Bengal v. John Gregory Apear & Another (1979) 119 ITR 192.

26. RM, P.Al.A. Alagappa Chettiar v. Controller of Estate Duty, Madras (1966) 60 ITR 289.

27. Controller of Estate Duty, Bombay v. Xac Cadar Xec Usman (1982) 8 Taxman 168 (Bom).

28. H.C. Khanna, v. Controller of Estate Duty, Madras (1977) 107 ITR 373.

29. Controller of Estate Duty, Madras v. Estate of Late R. Ramanujam (1977) 108 ITR 273.

30. Ralli Brothers Ltd. v. Inland Revenue Commissioners (1966) AC 483.

31. D.J. Gazdar v. Controller of Estate Duty, Bombay (1982) - 10 Taxman 169 (Bom.).

REFERENCES

1. Atkinson, A.B. (1972). Unequal shares. (Allen Lane).

2. Byrne, W.J. (1980). Recent Developments in Capital Gains Taxation. Finanzarchiv, Band 38.

3. David, Martin (1968). Alternative Approaches to Capital Gains Tax. The Brookings Institution.

4. Estimates Committee. (1981-82), Twenty Ninth Report, Part II.

5. Flemming, J.S. and Little, I.M.D. (1974) Why We Need a Wealth Tax. London. (Mathuin).

6. Goodhart, W. (1980), Capital Transfer Tax on Discretionary Trusts - A New Approach. British Tax Review.

7. Government of Australia (1975). Full Report of the Taxation Review Committee. (Chairman:K.W. Asprey).

8. Government of India, Ministry of Finance (1978). Report of the Direct Tax Laws Committee. (Chairman: C.C. Chokshi).

9. Gulati, I.S. (1957). Capital Taxation in a Developing Economy (India), Bombay: Orient Longmans.

10. Harbury, C.D. and Hithens, D.M. (1979), Inheritance and Whealth Inequality in Britain, George Allen and Unwin.

11. Harbury, C.D. and MacMohan, P. (1973), Inheritance and the Characteristics of Top Wealth Leavers in Britain. Economic Journal. September.

12. Kaldor, N. (1956). Indian Tax Reform. (Government of India).

13. Kay, J.A. and Kind, M.A. (1980). The British Tax System. Oxford University Press.

14. Meade Report (1978). The Structure and Reform of Direct Taxation, London: George Allen and Unwin

15. National Institute of Public Finance and Policy (1982). Property Tax Reform in West Bengal. (Government of West Bengal, Report of the West Bengal Municipal Finance Commission, Supplimentary, Volume II).

16. O.E.C.D. (1979). The Taxation of Net Wealth, Capital Transfers and Capital Gain of Individuals. Organisation of Economic Co-operation and Development, Paris.

17. Prest, A.R. and Barr, N.A. (1979), Public Finance in Theory and Practice. London: Weidenfeld and Nicolson.

18. Sanford, C.T. (1971). Taxing Personal Wealth. George Allen and Unwin.

19. Sanford, C.T., Willies, J.R.M. and Ironside, D.J. (1973), An Accession Tax. London: Institute for Fiscal Studies, Publication No. 7.

20. Sandford, C. T., Willies J.R.M. and Ironside, D.J. (1974). The Relationship of Wealth Tax to Other Taxes. British Tax Review.

21. Sandford, C. T. Willies, J.R.M. and Ironside, D.J. (1975). An Annual Wealth Tax. London: Heineman Educational Book Ltd., for the Institute of Fiscal Studies.

22. Shah, K.T. (1921). Sixty Years of Indian Finance. (Bombay Chronicle Press).

23. Shoup, Carl (1966). Federal Estate and Gift Taxes. The Brookings Institution.

24. Tait, A.A. (1982), Net Wealth, Gift and Transfer Taxes. (Mimeo).

25. Thurow, L.C. (1972), Net Wealth Taxes, National Tax Journal, September.

26. Vickrey, W.S. (1947), Agenda For Progressive Taxation. New York : Ronald Press.

NIPFP Library

6809
336.2760954 B140 M3