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Estate Duty Act

A critical analysis of the journey so far

Estate Duty Act: A critical analysis of the journey so far

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Abstract

Inheritance tax or Estate Duty, as it has been called in India, is a much discussed and debated issue in light of recent indications of its reintroduction by the Government. Inheritance tax is often considered to be an unpopular subject in jurisdictions across the world as it is viewed as double taxation in some quarters. Notwithstanding this perceived unpopularity, a rationalized implementation of inheritance tax may result in a stable source of additional revenue for the Government. This additional revenue may be utilized by the Government to undertake development activities or to reduce the burden of other taxes on medium and low income groups. In this article, the authors have analyzed the working and implementation of the erstwhile Estate Duty (as one way of imposing a tax on inheritance) in India and the form and manner in which a similar tax may be reintroduced in the country. The authors have taken assistance from similar taxes in other jurisdictions to analyze the efficiency and efficacy of a tax on inheritance in the Indian context. Towards the end of the article, the authors comment on the probable from and structure in which a tax on inheritance may be reintroduced in the country in the near future.

Introduction

Estate duty was a form of tax which was levied on the total value of the property held by an individual calculated at the time of his / her demise. It was payable at the time when the deceased individual's property was passed on to the successors. Estate duty was payable only if the total value of the inherited portion of the property exceeded the exclusion limit prescribed under the Estate Duty Act, 1953 ("**the Act**"). In India, estate duty was set at a rate as high as 85% (eighty five per cent). However, in 1985, estate duty law was abolished in India.

While India does not currently provide for a levy of estate duty, in the recent past, a few reports by the Government have suggested/ triggered a wide spread speculation that estate duty may be reintroduced in India. Speculations are rife in the market that the Government may reintroduce the levy of estate duty as it would serve as a stable source of revenue for the Government and may give a boost to India's economy.

Imposition and Abolition of Estate Duty in India

In India, in terms of the Act, the property deemed to pass on death included property which the deceased individual at the time of his / her death was competent to dispose of, and property in which the deceased individual or any other person had an interest ceasing on the former's death.[1] Further, (a) if the deceased individual was domiciled in India at the time of his death, the duty was leviable on all immovable property situated in India, and on all movable property (situated in India or outside) which passed on upon his death[2]; and (b) if the deceased individual was domiciled outside India, the duty is leviable on all immovable property situated in India, all movable property situated in India and movable property situated outside India, if it is settled property and the settler was domiciled in India at the time the settlement took effect.[3]

While calculating the total value of the property of the deceased individual, the market value as at the time of the death was taken into consideration.[4] Certain deductions were permissible from the value so determined, subject to certain limitations, on account of reasonable funeral expenses and for debts and encumbrances.

The Act contained various provisions to counteract attempts at legal avoidance. One set of provisions was that the gifts made by an individual 'in contemplation of death' *(donatio mortis causa)* as defined in the Indian Succession Act, 1945, were treated as passing on death of such individual.[5] Gifts *inter vivos* for public charitable purposes made within a period of 6 (six) months before the death, and gifts for other purposes made within 2 (two) years before death takes place, were also treated as passing on death.[6] Such gifts, however, were exempted from duty up to a maximum of INR 2,500 (Rupees two thousand five hundred) in case of gifts for charitable

purposes and of INR 1,500 (Rupees one thousand five hundred) in case of other gifts.[7] Further, where the deceased individual had transferred any property to a controlled company and derived any benefits from it, a part of the assets of the company were deemed to be property passing on his / her death, in the same proportion as the benefits derived by him / her during last 3 (three) accounting years of the company bearing to the income of the company in those years.

Like all other tax legislations, one of the objectives behind imposition of estate duty was to increase state revenue. Additionally, the other important objective of the tax was to prevent accumulation and preservation of wealth in the hands of a few and reduce the stark economic disparity between the rich and the poor in the country and consequently achieving a more egalitarian distribution of wealth. Despite the *bona fide* objective of the duty, it faced a lot of criticism from multiple sectors throughout the three decades it was in force. The Act was widely perceived to be a complex piece of legislation, primarily owing to the different valuation rules for different kinds of property. The complexities resulted in increased number of litigations relating to determination of principal value of the property. Further, estate duty and wealth tax were together seen as double tax on the same base and were thus criticized as being onerous. Collection of tax was meagre and it was reported to constitute a miniscule percentage of the total direct tax collected by the central government during the relevant years. On the other hand, the administration cost incurred by the government remained high, *inter alia*, on account of the large number of litigations. Practice of holding *benami* properties was prominent and it was important to put in place an efficient legislation in order to curb the practice. A lot of inherited properties remained illegitimately concealed from the purview of tax and therefore the rate of tax collection was low.

Estate duty law was abolished in 1985. One of the most important factors which led to its pitfall was the high cost and time involved in the administration of collection of estate duty compared to the actual estate duty collected. Apart from the high administrative costs involved in implementation, imposition of the estate duty was alleged to have caused disruption to the financial economy of Indian families.

International Trend On Inheritance Tax

It is interesting to note countries like the United States of America, United Kingdom, Canada and France also impose a tax on inheritance. In these jurisdictions, the basic rationale behind imposition of a tax on inheritance is to reduce social inequality and to facilitate economic redistribution of wealth (in addition to the tax being an additional source of revenue for the government.

In England, estate duty was introduced in 1894 as a 'back tax' and the principal taken into consideration for its imposition was that estate duty represented the duty due from the estate to the State. It was believed that the title of the State to a share of the accumulated property of the deceased is anterior to that of the interest to be taken by those who are to share it. Inheritance tax is also viewed as a tool to decrease inflation in residential property as some property may be sold to pay the tax, thereby bringing more property into the market which would align the supply of property with the increasing demand.

In the USA, inheritance tax is seen as a means to prevent accumulation of wealth in a few hands and to provide equal opportunities to the citizens irrespective of their social or economic backgrounds.

A brief outline of the applicable law in relation to inheritance tax in the aforementioned countries is as follows:

United States of America (USA)

- In terms with the law of inheritance taxation in USA, estate tax is applicable to the value of the estate, held by an individual at any place in the world, which is transferred upon his / her death. Therefore, a citizen of USA is liable to pay estate tax on his / her entire estate irrespective of the estate being in USA or outside USA.

- The rate of estate taxes in USA capped at 40% (forty per cent), with the estate and gift tax exemption threshold being $5.49 million per person for 2017. The exemption gets doubled to $10.98 million for married couples filing joint tax returns. Besides the estate tax (a federal tax) several states have a state-level estate tax over and above the federal limit.

United Kingdom (UK)

- The taxation of individuals in the UK is determined by their domicile status or by their residential status. The tax is levied on the worldwide estate of the deceased who was domiciled in the UK. UK has a uniform regime of estate and gift tax called inheritance tax. It is applied on the value of an individual's estate when he or she dies (in which case he or she is deemed to make a transfer of the whole estate immediately before such time) and to certain transfers or gifts made during the lifetime of an individual.
- Presently, the standard rate of the inheritance tax is set at 40% (forty per cent), with an exemption threshold of £ 325,000 (Pound Sterling three hundred twenty five thousand). If the estate is given to the children or grandchildren, the threshold increases to £ 425,000 (Pound Sterling four hundred twenty five thousand).

Canada

- Canada does not have an estate tax, the taxation of individuals in Canada is determined by residence. In Canada, after the death of a person, their estate is considered to have been transferred to their spouse and if the spouse is not there, the deceased is considered to have sold their estate at fair market price immediately before his death. This results in recognitions of some amount of gain/loss which is included in computing income in the year of death. These gains are further taxed at the applicable capital gains tax.
- The deemed disposition at death applies to the worldwide assets of all Canadian residents at the time of death. Non-residents may also be liable for tax at the time of death if they own taxable Canadian property.

France

- In France, the estate tax rate is varied between a minimum of 5% (five per cent) to a maximum of 60% (sixty per cent) with several tax slabs in between. There is a condition, whereby, if the beneficiaries are children or parents of the deceased, and the value of taxable inheritance (after permitted deduction) is up to € 8,072 (Euro eight thousand seventy two), the tax rate is 5% (five per cent). Whereas, if the value of taxable inheritance is above € 1,805,677 (Euro one million eight hundred five thousand six hundred seventy seven), the tax rate is 45% (forty five per cent).
- If the beneficiary does not fall within the category of children, parent, brother, sister, nephew or niece, the taxable inheritance (after permissible deduction), is taxed at the rate of 60% (sixty per cent).

In Japan, the estate tax rate ranges between 10% (ten per cent) to 70% (seventy per cent); in South Korea, the estate tax rate is up to 50% (fifty per cent); in Spain it varies between 7.65% (seven point six five per cent) to 34% (thirty four per cent).

In general, the estate tax is levied only when the inheritance value is above the specified threshold. The rate is generally dependent on the value of inheritance. In some countries it is also dependent on the relationship of the beneficiary with the deceased as seen in the above example of France.

Probability Of Reintroduction Of Estate Duty In India In The Near Future

As mentioned above, speculations are rife in the market that the Government may reintroduce estate duty in the coming years. In 2014, the minister of state for finance expressed that he was in favour of bringing back the inheritance tax in some form. Further, there have been recent reports in 2017 which suggest that the government intends to bring back the inheritance tax. While the recent budget for the year 2018-19 did not bring about any such provision, these speculations refuse to die down and the market sentiment continues to indicate that estate duty will be imposed in the near future.

According to a recent report, 58% (fifty eight per cent) of the entire wealth of India is concentrated with the top 1% (one per cent) of the population of India which earns the highest income. Given that the global average is 50% (fifty per cent), there is a growing concern about the increasing economic disparity in India. Considering that the intention behind reintroducing estate duty will be to avoid accumulation of wealth in the hands of few and to bring about economic equilibrium, imposition of estate duty may seem desirable. However, given that gift tax is currently applicable to several kinds of transfers without consideration, In the event the government reintroduces estate duty or any other form of inheritance tax, it must be ensured that such tax does not lead to double taxation over and above gift tax.

A fair share of Indian businesses are run by business families and therefore reintroduction of estate duty will impede economic growth of the country. This is because, in wake of a tax on inheritance, Indian promoters may give up their residential status or business operations may move overseas as tax planning measures. It may also be argued that when the deceased has already paid income tax and (in many cases) wealth tax each year for possessing the assets, itis harsh to levy inheritance tax on the same assets as this in a way amounts to double taxation.

The kind of law Government may introduce is unknown, however, taking a clue from the Estate Duty Act, 1953, the year 2017 has witnessed a struggle amongst taxpayers to transfer, settle or gift their assets to their intended successors during their life time in order to avoid the payment of estate duty on their death. Further, a number of high net worth individuals ('**HNIs**') have started taking measures (like family trusts, *benami* transactions, gifts) to shield their assets from being covered under the tax bracket.

Conclusion

Estate duty law is a domain with great prospects of either building and restructuring the tax regime in an economy or leading to causation of widespread problem and disparity to the people at large. Therefore, a lot depends on how the tax is structured, what is the threshold for imposition of the tax, what is the rate at which tax is levied, what kinds of properties are brought under the purview of the tax, what exemptions are granted, how easy or difficult administration and collection of tax is etc. While the impact of reintroduction of estate duty may be profitable for the Government, it may prove unfavourable for a large number of families as it may severely affect their asset base and act as a burden for the legal heirs who might have to forcibly sell the bequeathed assets to discharge the liability with respect to the estate duty. In the event estate duty is reintroduced in India, it would require a careful deliberation on its structure for implementation.Therefore, Government needs to guide the two laws simultaneously – law to tackle the issues relating to *benami* transactions, and uncontaminated inheritance law controlling its avaricious outreach.

Nonetheless, given that most HNIs have already tried to safeguard their wealth from the imposition of estate duty, it has to be seen whether (i) estate duty/inheritance tax will actually be imposed by the Government at all; (ii) if yes, whether the Government will base its new law on the former Estate Duty Act, 1953; and (iii) whether the new law will take effect retrospectively or prospectively, since a large amount of Indian wealth has already been / will already be settled into private trusts.

1 Section 2(15) of the Estate Duty Act, 1953.
2 Section 21(1)(b)(i) of the Estate Duty Act, 1953.
3 Section 21(1) (a) and (b) of the Estate Duty Act, 1953.
4 Section 36(2) of the Estate Duty Act, 1953.
5 Section 8 of the Estate Duty Act, 1953.
6 Section 9(1) of the Estate Duty Act, 1953.
7 Section 33(1) (a) and (b) of the Estate Duty Act, 1953.

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