Inheritance Tax

For Prelims: Economic and Social Development, **Sustainable Development**, **Poverty**, Inclusion, **Demographics**, Social Sector Initiatives, etc.

For Mains: Indian Economy and issues relating to planning, mobilisation, of resources, growth, development and employment.

Source: IE

Why in News?

Recently, a prominent political leader of India's opposition party has expressed interest in the proposed legislation on **Inheritance Tax.**

- There has been a lot of discussion about using **inheritance tax** as a tool for redistribution of wealth to address **Income Inequality** in India.

What is Inheritance Tax?

- **About:**
  - Inheritance tax is a tax paid for **inheriting a property or asset** from a deceased person.
  - It is levied on the **value of the inheritance** received by the beneficiary, and it is **paid by the beneficiary.**
  - Depending on the country, it can be as high as 55%.
  - A person can receive inheritance either **under a Will** or under the **personal law** of the deceased.
  - **In India,** the concept of levying tax on inheritance **does not exist** now.
- **Calculation of Inheritance Tax:**
  - The first step is to determine the **total value of assets.**
    - This involves assessing the value of all assets owned by the deceased, including real estate**, investments**, bank accounts, vehicles, and personal belongings, while also considering any outstanding debts or liabilities.
  - Whether or not inheritance tax applies depends on several factors, including the total value of the estate and the laws of the jurisdiction.
    - In some places, certain beneficiaries, such as spouses or children, may be exempt from paying inheritance tax or may receive a reduced tax rate.
- **Reason to Abolish it:**
  - **Procedural Harassment:** Taxpayers were being unduly harassed with the existence of two separate taxes on property ie. **wealth tax** (before death) and **estate duty** (after death).
  - **Unmet Objectives**: There was no reduction in the unequal distribution of wealth whereas, the tax did not assist states in financing their development schemes significantly either.
  - **Economically Not Feasible**: While the yield from estate duty is only about Rs 20 crore in 1985, whereas its cost of administration and collection was relatively high.

- **Tax Evasion:** High rates of taxation often result in flight of capital and investment to tax havens or tax jurisdictions with favourable tax rates.

Examples of Inheritance Tax Around the World

- Most European, American and even African nations levy inheritance tax.
- In Europe, the top nations levying tax on inherited properties are France (60%), Germany (50%), United Kingdom (40%), Spain (33%) and Hungary (18%).
- Other countries with high inheritance taxes are Japan (55%), South Korea (50%), Ecuador (37%), Chile (25%), South Africa (25%) and Taiwan (20%).

What Factors Influence the Demand for Implementing Inheritance Tax in India?

- **Rise in Wealth and Income Inequality in India:**
  - According to the **World Inequality Report 2022**, India ranks among the most unequal countries globally, with the **top 10% and top 1% holding 57% and 22% of the** national income**,** respectively.
    - Meanwhile, the share of the bottom 50% has decreased to 13%.
  - India exhibits staggering **wealth inequality**, with the top 10% of the population holding 77% of the total national wealth.
  - The **richest 1% owns 53% of the country's wealth,** leaving the poorer half with a mere 4.1%.
- **Tax Burden on Poor:**
  - Approximately **64% of the total** goods and services tax (GST) in the country **came from the bottom 50% of the population**, while only 4% came from the top 10%.
- **Lack of Inclusive Growth:**
  - **Skewed Distribution of Economic Gains:** Economic growth may disproportionately benefit certain sectors or income groups, leading to an uneven distribution of wealth.
  - **Lack of Social Safety Nets:** Inadequate social safety nets and welfare programs may leave vulnerable populations without sufficient support, widening the wealth gap.
    - According to **NITI Aayog's** National Multidimensional Poverty Index (MPI)**,** India's population living in multidimensional poverty was **14.96%** in 2019-21.
      - The rural areas of India experienced multidimensional poverty of **19.28%.**
      - In urban areas, the poverty rate was **5.27%.**
  - The **Gini wealth coefficient** in India has gone up from 81.3% in 2013 to 85.4% in 2017 (100% represents maximal inequality). The growth in India has not been inclusive.
- **Endowments to Social Sector Institutions:** Endowments and funds from **inheritance tax** are essential for Indian hospitals, universities, and other institutions. For example, **Harvard University, receiving funds from estates, is exempt from inheritance tax.**
- **Need for more Direct Taxes:** The government's **fiscal deficit** has increased in recent years. Hence, additional sources of direct taxes like inheritance tax need to be explored to contain the fiscal deficit as mandated by the **FRBM Act.**
- **International Practices:** Developed countries such as England, France, Germany, the USA and India's Southeast Asian counterparts like Philippines, Taiwan and Thailand have been charging inheritance tax.

World Bank Study 2000 (India's poverty Reduction During 1970s-1990s)

- When GDP growth picked up from a mere **3.5%** in the initial years, India could achieve a sustained decline in poverty.
- The study found that a staggering 87% of the cumulative decline in poverty was attributed to the **rise in the growth of mean consumption,** while **redistribution** contributed to only **13%**.

What are Advantages and Challenges in Implementation of Inheritance Tax in India?

- **Advantages:**
  - **More Efficient Dispersion of Wealth:** In India, the richest and wealthy families inherited a large amount of wealth.
    - This is not only unhealthy from an economic perspective, but also restricts social mobility.
    - Thus, a proper implementation of **inheritance taxes** can remedy this malaise to a considerable extent.
  - **Based on Egalitarian Ideals:** The redistribution of initial endowments is an important step in that direction to ensure equality as enshrined on the Principle of the **Right to Equality** in the Constitution of India.
  - **Additional Source of Revenue for Public Welfare**: Inheritance tax provides additional sources of revenue to the government for **expansion of social sector programmes,** and its push towards public welfare schemes.
  - **Progressive in Nature**: Inheritance tax is a progressive tax as it places a higher tax burden on wealthy individuals only.
    - By this additional tax revenue collected in the form of Inheritance Tax, the Government would have the liberty of reducing the basic **income tax liability** on the economically weaker sections of the country.
    - This could help combat the high barrier to entry to starting more entrepreneurial ventures.
- **Challenges:**
  - **Complexity of the Tax Structure**: India already has a complex tax system with multiple taxes at the central and state levels.
    - Introducing an additional tax like inheritance tax would add to this complexity, making compliance and enforcement challenging.
    - Enforcing and administering an inheritance tax requires a robust administrative infrastructure.
  - **Resistance from Wealthy Families:** Wealthy families in India may resist the imposition of an inheritance tax, as it would reduce the amount of wealth they can pass on to their heirs.
    - This resistance could manifest politically and socially, making it difficult for the government to introduce and sustain such a tax.
    - Inheritance taxes can have implications for family-owned businesses, particularly in sectors where succession planning is crucial.
  - **Lack of Comprehensive Data:** Implementing an effective inheritance tax requires accurate data on individuals' wealth and assets.
    - In India, there may be challenges in collecting comprehensive data on inheritance and wealth distribution, especially in rural areas where informal economies are prevalent.
  - **Avoidance and Evasion**: High net worth individuals may attempt to avoid or evade inheritance tax through various means such as **trusts**, offshore accounts, or gifting **assets** during their lifetime.
  - **Impact on Agricultural Land:** In India, agricultural land holds significant cultural and economic value, and it often passes down through generations.
    - Imposing an **inheritance tax on agricultural land could face resistance from agricultural communities** and lead to concerns about the fragmentation of landholdings.

What other Similar Taxes Does India Have?

- **Death Tax:** In 1953, India's Parliament had passed the **Estate Duty** 'Death Tax**' Act,** which was later abolished in 1985.
  - As per the Act, **tax/duty was imposed on the principal value of movable and immovable property,** including agricultural land, passed on to any person after the death of the owner of such property.

- The Act was applicable only if the property-owning person died as an **adult** (i.e. completed 18 years of age).
    - Also, **Estate duty** was applicable only on inherited properties with a value above the exclusion limit set by the Act, and the tax rate was calculated as per the market value at the time of death.
- It included **immovable and movable property** owned by the deceased in India and outside, which were passed on to a successor– if the person died when domiciled in India.

- **Gift Tax:**
    - The **Gift Tax** Act was passed by **Parliament in 1958**. It imposed a duty on any 'gift' made by one person to another in that financial year.
    - It was imposed with a duty at the rate of **30%**.
    - A gift was defined as **any existing movable or immovable property** transferred by one person to another **voluntarily, without considering its value** in terms of money, after 01st April 1957.
    - The purpose was that the government sought to recover some of the tax revenue lost when a high income tax donor transferred property to a donee falling in the lower income tax bracket.
    - Due to similar constraints to those faced while implementing estate duty, this tax was **abolished in 1998**.
    - It was reintroduced in **2004** in the **Finance Act** as part of additions to the **Income Tax Act.**
        - Any cash gifts above Rs. 50,000 and any gifts in kind (i.e. immovable property) above the value of Rs. 50,000 are taxable.
        - Exceptions include donations, inheritance, and gift money received during weddings.
- **Wealth Tax:**
    - It was introduced in **1957** to impose a duty on a person's net worth.
    - A **1% duty** was imposed on earnings of **over Rs 30 lakh** earned by a citizen in that **financial year.**
    - The tax was imposed on all assets of Indian citizens and only Indian assets of **non-residential Indians (NRIs).**
    - Assets under the purview of this regime were gold, silver, and platinum ornaments, transport vehicles like private aircrafts, ships, and cars, property apart from one's residential home, and any cash above Rs. 50,000.
    - Exemptions under the law included rental properties, business property, smaller properties below the prescribed limit, and investments in schemes.
    - This tax was also **abolished in 2015** due to heavy costs in execution.

Way Forward

- **Introduction of Higher Threshold**: If the government intends to introduce an inheritance tax, it should introduce it with a higher threshold, so that only the super-rich are taxed.
- **Provisions of Exemption for Donations:** The endowments by the super-rich to hospitals and universities should be exempted from the inheritance tax calculations.
- **Improving the Government's Tax Administrative Capacit**y: The tax agencies should take advantage of advanced technologies to reduce the cost of administering and monitoring compliance with inheritance tax.

Drishti Main Question:

What is inheritance tax and why it was abolished in India? Discuss its desirability and impact on reducing economic inequality in India.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims

Q. The term 'Base Erosion and Profit Shifting' is sometimes seen in the news in the context of (2016)

(a) mining operation by multinational companies in resource-rich but backward areas

(b) curbing of the tax evasion by multinational companies

(c) exploitation of genetic resources of a country by multinational companies

(d) lack of consideration of environmental costs in the planning and implementation of developmental projects

Ans: (b)

Q. There has been a persistent deficit budget year after year. Which of the following actions can be taken by the government to reduce the deficit? (2015)

1. Reducing revenue expenditure
2. Introducing new welfare schemes
3. Rationalizing subsidies
4. Expanding industries

Select the correct answer using the code given below:

(a) 1 and 3 only

(b) 2 and 3 only

(c) 1 only

(d) 1, 2, 3 and 4

Ans: (a)

Mains

Q. Enumerate the indirect taxes which have been subsumed in the Goods and Services Tax (GST) in India. Also, comment on the revenue implications of the GST introduced in India since July 2017. **(2019)**