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Inheritance tax –A strategy to wealth equalities

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ABSTRACT

Wealth inequalities are the main concern in the perspective of emerging economies. Across the globe, the emerging economies are experiencing extreme wealth inequalities. Indian economy is not an exception for this unequal distribution of wealth. The OXFAM 2017 report says that just about 1% of the Indian rich have cornered about 73% of all of Indian wealth. The year 2017 saw an unprecedented rise in the "number of billionaires, at a rate of one every two days". Billionaires' wealth has increased on an average by "13% since 2010, six times faster than the wages of ordinary workers which have increased at a yearly average of 2%". To overcome the problem of unequal wealth distribution could be the introduction of inheritance tax. In words of Arthur O'Sullivan, "Inheritance tax is a tax paid by a person who inherits money or property or a levy on the estate (money and property) of a person who has died". Piketty (2014) puts a strong case for levying inheritance tax while evaluating optimal inheritance taxation. The present paper tries to make an attempt to provide justification for the introduction of inheritance tax in Indian economy, so that the wealth inequalities can be reduced. This paper provides an analysis of cross country experiences with inheritance tax. Also the paper provides a historical background of inheritance tax in Indian economy. It also provides solution and alternative strategy to eliminate wealth inequalities.

Key Words : Estate tax, Inequalities, Property, Caste discrimination, Progressive taxation

INTRODUCTION

With focus on equitable growth and human development sharpening, the countries around the globe are orienting their policy framework, towards equal distribution of income and wealth. To achieve this equity, economies have always tried to mobilize resources and redistribute them, both income and wealth, in an equitable manner laying a foundation for future welfare and development. With ambitious public spending and mammoth welfare schemes many countries face immense challenges of addressing humungous fiscal deficits compounded by massive and sophisticated tax evasions. To counter this challenge, modern governments are always striving to raise revenues with alternative taxation instruments and innovations. One of the prominent taxation measures has been inheritance tax, also known as Estate Tax. "An inheritance or estate tax is a tax paid by a person who inherits money or property or a levy on the estate (money and property) of a person who has died". The proceeds from inheritance tax are considered an income for the treasury and are pooled with other taxes such as Income Tax and GST which are used to finance the expenses

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of the government. Although experience shows that inheritance tax contributes very less to the overall Government revenues compared to other taxes, it helps in achieving an important aim of the wider Taxation System and philosophy *i.e.* equitable income and wealth distribution. Inheritance tax squarely targets the issue of wealth inequalities.

Twentieth century has witnessed the decline of the doctrine of communism and the rise of capitalism. There is no denying that capitalistic economies have provided a fundamental ethic for scientific progress with clear incentives to perform and compete with excellence.

Thus, the need to have income differentials which distinguish performance and merit are well understood and institutionalised. Eventually pursuit of this philosophy while promoting growth and all round excellence leaves people at different levels in the social and economic hierarchy. Noble Laureate Milton Freidman while opposing wealth taxation as antithetical to capitalistic spirit explained his proposition in the following manner. He opined that family and not individuals is the basic unit of society. The basic functional unit of society, he postulates, is the family and it is for the family that individuals are willing to scrounge and save for, and it is this psychological disposition that makes men and women build capital. Thus capitalism and science can perhaps credit some of its overwhelming success to the family. He says that inheritance tax is flawed as society is based on family functionality and not on individual aspirations. It is this love for children which is at the fulcrum of capitalistic excellence in promoting investment and innovation. If inheritance is taxed it would predispose society to conspicuous consumption and there would be little capitalistic investment. Society could actually get destroyed because of lack of initiative and incentive. Thus, inheritance has been projected by capitalistic societies as being crucial to the survival of society. That the growing inequalities and lack of opportunities to the majority of the populations and the consequent loss of human ingenuity to declining social opportunities engendered by such inequitable social frameworks was left unanswered.

Contrary to the capitalists, the popular view among the socialists is that those who are able and have accumulated wealth must pay for those who are deprived and unprivileged. The concept of direct taxes, especially taxation of income, wealth and estates stems from the above belief. The logical conclusion of this belief, is formulation of rules and systems by which those who had experienced extraordinarily high income and wealth are taxed proportionately either every year or at some important points of time for example inheritance tax is levied at the death of an asset holder while the asset is being passed on to the legal determined heirs. Today there is clear evidence of an increasing trend towards inequality in both income and wealth across the globe, this despite the avowed aim of the tax system which decidedly aims to reduce income and wealth inequality. Adam Smith explains that, “Such things as defending the country and maintaining the institutions of good government are of general benefit to the public.” Therefore, it is just that the people should contribute in the above causes. The taxman should be cautious about people’s ability to pay and the incidence of tax. Inequalities are substantially high in developing economies than in developed economies with many developing countries lacking adequate fiscal structure to significantly reduce the huge inequalities and gaps.

The present paper makes an attempt to examine the need for and the role of inheritance tax in India in the context of widespread and widening social and economic inequalities.

Inheritance tax- need and concerns :

Is there a need for inheritance tax? There are various considerations in answering this question. Haslett (1986) argues that inheritance works against some ideals of capitalistic societies. Capitalist societies encourage individuals to be more productive by incentivising them to benefit from their productive activities. Second, equality of opportunity can make societies most productive. Wealth can be considered an opportunity and unfortunately the principle of inheritance results in great differences in income and wealth distribution thus belying equality of opportunity. Third, freedom of choice is restricted on account of the wealth that individuals possess. With greater wealth, one can have greater freedom of choice in different aspects of life and denying this freedom to a large section of population by virtue of perpetual inheritance will reduce the distribution of freedom of choice in society.

At a practical level, there are two other considerations that need to be kept in mind while addressing this question. One is the negative externalities associated with concentration of wealth and the other is the revenue implications of an inheritance tax. Concentration of wealth in a few hands has negative effects on social and political processes and can have dangerous consequences for the society as a whole if not restrained (Joulfaian, 1998). Monopoly is a major cause of wealth concentration and letting a monopoly thrive is easier when the owners are able to directly influence political process in various ways. And also, as previously explained concentration of wealth interferes with the provision of equal opportunity for all. Individuals with access to larger amounts of resources are relatively better off and can influence political and economic processes to their advantage.

As far as revenues are concerned, inheritance tax contributes very small, if not negligible portion of the overall revenues of the governments across the world. Although, there are concerns of efficiency and administrative costs of inheritance tax, the positive outcomes in terms of re-distributional effects far outweigh these concerns. With the rapid growth of information technology effective implementation of inheritance tax and the consequent revenues it will raise would also substantially increase when imposed.

Review of literature :

Some of the pioneering studies have been examined in the light of viability and sustenance of Inheritance Tax.

Hunter (1921) explained that the governments of modern economies had been experiencing an increasing pressure to enhance their public expenditure mainly for the provision of public goods. The common cost functions include investing into defence and security, providing social security to its citizens such as "*establishment and maintenance of educational systems; the provision for defectives, delinquents and dependents; the protection to person, property and health; the building and maintenance of highways; and the regulation of railroads and public utilities*". Inheritance tax had drawn lot of support from people across all groups. *"Because it can be used to encourage a social equality and as a means for a fairer distribution of tax burdens, it has found its most extensive development in more democratic countries, such as Great Britain, Switzerland and the United States".* Inheritance tax draws natural support from all socialists urging for equity and redistribution of resources. Inheritance tax had found central importance amidst the call for a more progressive tax regime

Amongst the statesmen, Theodore Roosevelt favoured taxing inheritance. A very interesting advocate of inheritance taxation was the Scottish industrialist and Philanthropist Andrew Carnegie who termed inheritance as a mark of misguided affection from parents to leave great fortunes for their children. Political economist John Stuart Mill and famous utilitarianism philosopher Jeremy Bentham are among the big names who advocated the taxing of Inheritance. Thomas Piketty is one among the strong advocates of inheritance taxation who along with Emmanuel Saez worked on evaluating optimal inheritance taxation.

Joulfaian (2006) in his paper while examining effects of Inheritance Tax explains that taxing inheritance has the effect of depressing taxable estates significantly. People tend to report reduced size of taxable estates. He suggests that "In the absence of estate tax, there will no longer be a need to engage in estate planning and or employ strategies designed to reduce the reported value of assets". Feldstein (1999) argues that this kind of response reflects a welfare cost of estate taxation.

What are the factors that enable a government to tax inheritance? It is generally believed that democracy in general and expansion of the franchise in particular creates an environment for a serious commitment to wealth and income redistribution and this generally involves taxing inheritance. However, Scheve and Stasavage (2012) shows that taxing inherited wealth has not much to do with democracy and extension of franchise and that democratization and redistribution may not be closely correlated. They argue that "support for progressive taxation is greatest when its advocates can make a convincing case that it is necessary to tax some individuals more heavily to compensate for some prior source of unfairness. In the absence of such an appeal, arguments that the rich should pay more simply because they have a greater ability to pay may fall on deaf ears".

In a study aimed to capture "effects of taxation on distribution of income and wealth in Japan", Hiromitsu (1980) examined the influence of income tax on income inequality doing a detailed analysis of re-distributional effects of taxation. The study also analyses the positive effects of inheritance and gift taxes on distribution of wealth. The inheritance and gift tax contribute to 2-3 per cent of total tax revenue in Japan which indicates that heavier reliance cannot be placed on inheritance tax than income tax for the purposes of revenues.

Thomas Piketty (2013) discusses the role of merit and inheritance in the mitigation of income inequalities in the 19th century. He explains that although the worldwide capital stock had remained the same but it has gone through deep structural changes due to the shift from inheritance of wealth to accumulation over the lifetime by savings from earned income with one plausible explanation of increased life expectancy in the 19th century. It further shows that the phenomenon of inheritance had re-emerged in late 70s and 80s of 20th century with a huge chunk of capital already accumulated and is getting transferred through inheritances.

Evidences at International level :

The countries across the world, including the OECD countries, practice the policy of inheritance tax in their tax structures. On an average, the OECD countries have 15 per cent as the inheritance tax rate. Japan has the highest tax rate at 55% followed by South Korea (50 %), France (45 %), UK and US (40 % each) (Tables 1 and 2). However, other OECD countries such as Canada, Israel, and Australia are among the few who abolished inheritance tax way back in 1970s due to administrative issues and instead brought in capital gains tax. It appears that there is a need for inheritance taxation in countries with a long history of graded inequality as opposed to newly formed nations. Also, high inheritance tax rates also lead to high exemption rates which in turn raises little revenue for the government and also then applies to very few households and may not have great

Table 1 : Countries with Inheritance Tax > 25 per cent

Country	Japan	South Korea	France	United Kingdom	United States	Spain	Ireland	Belgium	Germany	Chile
Tax Rate (%)	55	50	45	40	40	34	33	30	30	25

Source: Family Business Coalition

Table 2 : Countries with Inheritance Tax < 25 per cent

Country	Greece	Netherlands	Finland	Denmark	Iceland	Turkey	Poland	Switzerland	Italy
Tax Rate (%)	20	20	19	15	10	10	7	7	4

Source: Family Business Coalition

rationale in already societies which are already more equal.

Inheritance tax was brought forth in UK in the year 1796 bearing strong influence from French Revolution. The rationale to levy tax on inheritance was built on protecting the vulnerable poorer section of societies through financing there imminent needs and halting the very process of legacy transition. French philosophers assumed their prevailing economic system biased in helping the rich to remain wealthy and leaving the poor excluded, as resources were consolidated in the hands of already rich and wealthy. Their objective of taxing inheritance was to redistribute this accumulated wealth; taking it from the very rich through inheritance tax and redistributing it among the deprived population through various public benefiting avenues.

In the United States, the estate tax is levied on property that is transferred through a will statement or according to state laws of intestacy. Other types of transfers that are taxed includes intestate estate, the payments of some life insurance benefits and sums from financial account extended to beneficiaries. In the United States, the estate tax comes under larger *Unified Gift and Estate Tax* system.

Inheritance tax- Indian context :

Inheritance tax, or estate duty, was held for thirty three years, between 1953 and 1985. All assets below a threshold limit of Rs. 1 lakh were exempt while determining the taxable value of the estate, their assets, settling property in trusts, etc. There were litigations galore and for a Hindu Undivided Family (HUF) property, this threshold was Rupees 50,000.The highest slab rate in 1985 was 85% on an estate exceeding Rs. 20 lakh. Property, if passed to heirs two years before the death, was not taxed. The tax was payable only by legal heirs and if a person inherited property on the death of a spouse, no tax had to be paid. The short period experience of India taxing the inherited assets had been quiet discouraging with a similar story from many other economies, ending up in abolishing the inheritance tax. Owing to its inability in achieving its objectives of abating unequal wealth distribution and providing for financial help to states in their development plans, Inheritance tax law was repealed in 1985. In fact, the yield acknowledged from Inheritance tax was a pittance when compared to the cost incurred for its administration. Previous experiences has shown that people in India have resisted the inheritance tax policy and evaded the tax by gifting the inheritance, resulting in wasted government resources, which could have been better used elsewhere. And there was a great deal of harassment for both the heir and the exchequer. However the fact that wealth remained with the high castes especially the dominant castes and it passed from generation to generation affecting the socio-political economy of the nation right from the villages to the nation was overlooked when abolishing this tax. Across the nation the dominant castes hold landed property and engage in superior subordinate relations with other lower landless castes.

Addressing inequalities in India :

As of today, just about 1% of the Indian rich have cornered about 73% of all of Indian wealth

(OXFAM Survey). The year 2017 saw an unprecedented rise in no. of billionaires at a rate of 0.5 billionaires per day. Billionaires' wealth has increased on an average by 13% for last seven years, six times faster when compared to wages of unskilled workers which had increased at an annual average of 2%. It will take a minimum wage earner about 941 years to accumulate what hugely paid executive at any top garment firm earns annually. This is an abysmal reflection on philosophy behind the current inclusive growth initiatives. The social welfare schemes aimed at uplifting and betterment of poor and underprivileged hardly reaches them and a majority of the targeted beneficiaries appear to be left out from these privileges. Thus economic and social benefits don't seem to have percolated down in society. Trickledown economics have barely yielded results in equity; rather income generation has resulted in a widening gap between the rich and the poor.

The social context of India: Caste and class :

While there is a shift in global focus from China's economy to India's economy, India still has to meet huge challenges, in respect of inequalities. Disproportionate wealth is estimated for select top rich section in India. This is also due to the fact that government investment in the field of education and health stays highly inadequate and impaired its development agenda, such as the underfunded public health infrastructure in India with a meagre budget of 0.5% of GDP.

Other big challenges are the problem of the discriminatory caste system in India and the communal tensions between the Hindu majority and the Muslim minority. Though, the caste system was officially abolished in 1947 by ending the population census by caste, a system was developed by giving preference to children from deprived sections in admission to universities and employment in public-sector.

According to Thomas Piketty, the long run aim for an economy should be the gradual transformation from preferential admission policies to "universal social criteria of parental income or place of residence, along the lines of the software used for entry to schools or higher education (or for certain grants to firms)".

As per Piketty's and Chancel's estimates, share of the top percentile (top 1%) in India's na tional income was at its highest (22%) since 1922 and share of bottom half of India's population being reduced from 1980-2014. However, there were two issues associated with their analysis. First, they ruled out the possibility of under-estimation/reporting of incomes by the bottom 90% of the population; second, the changes in tax administration were not taken in to account that may have led taxmen to measure and assess top-income groups better than before. Therefore, leading to an exaggeration of the income estimates of top earners and under-estimating the income of the bottom group. Thus, what is required is to build an official and comprehensive database to address the distributional issues of the country.

Another estimate by Anand and Thampi reflects the differences in wealth and income across social groups. They show that the share of SC, ST and OBC in national wealth is lower relative to their population shares and also have deteriorated since 1991. Thus, low mobility across generations, both in terms of education and occupation, perpetuates the cycle of inequality. We need both better data and better analysis to deal with the complex issue of inequality in India. However it is clear that in India there is a significant caste class convergence. At the present juncture when India is experiencing a great demographic dividend, it is of paramount importance to address the issue of inequality, particularly in terms of providing productive opportunities to all the working age members of the population.

In this overall context, it is the right time to introduce the inheritance tax in India with an aim to achieve better redistribution of income and wealth. It may be a very small contribution to the treasury from the inheritance tax, but with better data availability and advanced communication technology, it will be easier for implementing the inheritance tax by effectively tracking and checking tax avoidance. Imposition and effective implementation of inheritance tax would go a long way in achieving desirable re-distributional outcomes in India. Its impact in breaking the caste class nexus will be critical for a socially and economically equitable India.

Conclusion :

Constitution of India with its emphasis on proportional representation of all castes and communities in all walks of life has disrupted the social system so institutionalised since time immemorial. Breaking this conundrum through the concept of reservations has resulted in division in society and a backlash wherein the argument that merit is being sacrificed at the altar of proportional representation has been well articulated. Caste based politics has further divided society and strengthened caste. It is believed that inheritance tax will break down caste hierarchy and is essential for Indian society than perhaps any other society. The antidote to caste is inheritance tax. Families who are placed differently by class in a capitalistic society receive differential treatment from society. A rich man's son gets private education and better skills and in all likelihood, have much greater chances of survival and success in the market than those who have been born to those at the bottom of the hierarchy. The rigidity of caste system in India vastly multiplies the disadvantages of inter-generational wealth and income gap in view of not just the caste class convergence but its associated rigid social mobility rules and extensive discriminations associated with birth ascribed social status. The way of reducing this gap between classes and castes is therefore fundamental to freeing our country from the clutches of its self-imposed constraints of a Hindu Rate of Growth.

In the year 1985, India abolished the inheritance tax sighting the reason of pittance collection with increasing administrative cost. Additionally, the governments at that time failed to efficiently monitor the evasion by taxpayers gifting their assets and forming trusts in the country and abroad. At present, with advanced information technologies and committed administrative mechanism there lies a strong case for reintroduction of Inheritance tax. Also, the black economy of the country has a great chunk of assets in the form of *benami* properties which could be traced and taxed for development and welfare purposes. Hence, the tax must be designed to curb inequalities in distribution of wealth and income. The tax implemented must be very gentle and generous bringing only assets with high values initially. Also, no inheritance tax on same generation transfers must be levied. A phased payment must be allowed to encourage high compliance rates and acceptability among taxpayers.

However, imposing Inheritance tax requires an extensive use of Information Technology and advanced administration mechanisms to check the evasion while taking very special care of people's right to privacy and personal freedom. In India, the peculiar circumstances of rigid social hierarchy give us an ideal ground to impose inheritance tax. It is the right cure for the disease of caste-based wealth transfers which if unchecked will be the bane of the future development of our country.

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