C H A P T E R - III

ANALYSIS OF WEALTH TAX EXEMPTIONS

CHAPTER - III
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3.1 INTRODUCTION

Section 5 of the Wealth-tax Act, 1957, as extracted from the Act, is already reproduced in the preceding Chapter and it reveals that the various exemptions granted under the law are intended to achieve various purposes, e.g. some of the exemptions are intended for the promotion and advancement of charitable objectives, while some other specific exemptions have been given to the former Rulers. As regards exemption for the interest of an assessee in the coparcenery property of a Hindu undivided family, it appears that the exemption has been provided as a matter of statutory rights in the joint property of the Hindu undivided family. An attempt is also made to promote and encourage the activities relating to the construction of residential houses as exemption has been provided also for dwelling units. some of the exemptions have been provided for certain specific types of deposits and savings, which, of course, are governed under section 5(1A)

Thus, it is clear from the provisions contained under section 5 that various purposes are intended to be served under the wealth-tax legislation. In the present Chapter, it is proposed to examine some of these exemptions.

3.2 ANALYSIS OF EXEMPTIONS

The very first exemption under the Section relates to the property held by an assessee under trust or legal obligation for any public purpose of a charitable or religious nature in India. The term 'charitable purpose' is specifically defined under law. The exemption is available for and from the assessment year 1957-58. With effect from 1.4.1986, the assets held in business are to continue to be exempt from payment of wealth-tax in the following cases:

1. Where the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or publication of books or the business is of a kind notified by the Central Government in this behalf in thce Official Gazette and separate books of account are maintained by the trust in respect of such business;
2. Where the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution and separate books of account are maintained by the institution in respect of such business;
3. Where a business is carried on by an institution, fund or trust refeerred to in clause (22) or clause (22A) or clause (23B) or clause (23C) of section 10 of the Income-tax Act, 1961.

In their commentary "Three Taxes", (1989 Edition), the authors K.Chaturvedi and S.M.Pithisaria, have explained the requisite conditions for availing these exemptions:

> *In order to attract the exemption provided for in section 5(1)(i), the requisite conditions are:*
>
> *(1) the assets must be held under a trust or other legal obligation;*
>
> *(2) these must be held for a public purpose;*
>
> *(3) the public purpose must be of a charitable or religious nature; and*
>
> *(4) the scope of such purpose must be confined to India.*
>
> *Unless all these conditions are satisfied, the exemption is not attracted.*[1]

The authors have also cited the following cases in support of their observations:

1. *CWT v. Huderabad Race Club, (1978) 115 ITR 453, 460 (AP);*
2. *Abdul Sathar Haji Moosa Sait Dharmastapanam v. CIT (1988) 169 ITR 84, 116 (Ker.)*[2]

From the above discussion, it is clear that the dominant objective which determines the eligibility for these exemptions concerns with the charitable purposes. The same authors have further clarified this point with the support of the relevant case law, as under:

> ***Primary or dominant object or objects are the determining factors*** *- If the primary or dominant object of a trust is charitable, other objects which are merely ancillary or incidental to the primary or dominant purpose, even if they are non-charitable, would not prevent the trust from qualifying for*

exemption from tax [CIT v. Adarsh Gram Trust, (1986) 159 ITR 41, 57 (Raj.)] In that case, the objects of the trust, namely, the promotion of manufacture of khadi, promotion of removal of untouchability, upliftment of women and formation of a modern village or "Adarsh Gram" were held to be essentially charitable objects being matters of general public utility. The residuary object specified in the deed of trust as "other constructive activities on the lines of the doctrine of Mahatma Gandhi" was held to take its colour from the preceding objects specified in the trust deed, as that is an ancillary or ancillary or incidental purpose, which must be read in conjunction withh and in the light of the other objects of the trust which have been specifically mentioned. In such a case, it is not permissible to read any one object of the trust in an isolated manner, but all the objects specified in the deed of trust have to be read together. It appears clearly from a combined reading of all the objects of the trust in the instant case that the trust was created with the primary or dominant purpose of charitable nature or for objects of general public utility. Therefore, the trust was entitled to exemption under section 5(1)(i).[3]

It would thus be amply clear that the exemption is exclusively available in respect of the property held for charitable or religious nature. The purpose for which the exemption is given must also be fostered in India. The definition of the term 'Charitable Purpose' is also given in the Income-tax Act, 1961, which is rather exhaustive and is reproduced as under:

Sec.2(15) : "charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility.

There are certain exemptions granted under section 5 which exclusively deal with specified deposits and investments. The basic purpose for which these exemptions have been granted is to provide certain incentives for mobilization of resources under certain schemes formulated by the Central Government. There are various types of deposits or shares or bonds listed in the section, but the significant aspect which has to be taken into account that these investments are governed by section 5 Therefore, section 5(1A) controls the aggregate investment of a sum of five hundred thousand rupees.

Another significant aspect in this section is that the various types of investments earn different rate of return and are intended for diverse objectives.

The Act has been substantially modified in respect of exemption covered under section 5(iii) which deals with:

> *furniture, household utensils, wearing apparel, provisions and other articles intended for the personal or household use of the assessee [but not including jewellery].*

In this case, although specific exemption has been given for household utensils, wearing apparels, etc., the exemption in respect of jewellery has been withdrawn with effect from 1.4.1963. The withdrawal came under the Finance Act, 1971. However, there is a contradictory provision within the section itself. If one goes through the provision under sub-clause (xiv), which reads as under:

> *Jewellery in the possession of any Ruler, not being his personal property, which has been recognized before the commencement of this Act, by the Central Government as his heirloom or, where no such recognition exists, which the Board may, subject to any rules that may be made by the Central Government in this behalf, recognize as his heirloom at the time of his first assessment to wealth-tax under this Act:*

This would reveal that the jewellery in possession of any Ruler is exempt.

Yet another important provision has been made in the Act as regards earning of foreign exchange through wealth-tax exemption in respect of any foreign exchange asset. The term 'foreign exchange asset' and the conditions governing the exemption have been incorporated precisely. However, this exemption is given in case of an individual who is a citizen of India or a person of Indian origin.

An attempt has been made in the above paragraphs to discuss some of the provisions relation to the exemptions of certain assets from the liability of the tax on wealth. It would not be desirable to discuss every provision as the list of exemptions under section 5 is quite exhaustive.

A perusal of the above referred discussions leads to the conclusions and suggestions which have been summarized in the succeeding Chapter.

3.3 GENERAL EVALUATION OF THE WEALTH-TAX ACT, 1957.

Although the purpose of the present study does not include within its scope an overall evaluation of the tax on wealth, it is still necessary to provide an overall picture of the operation of the Wealth-tax Act, 1957, particularly when the exemptions under section 5 of the Act adversely affect the tax collection. It would not be, therefore, inappropriate to record here the observations of G.Thimmaiah (as extracted from his work "Perspectives on Tax Design and Tax Reform"):

A Critical Evaluation:

(An) analysis of the operation of the three taxes on the ownership and transfer of wealth in India brings out the hollowness of the real populist nature of the slogan in the name of achieving a socialistic pattern of society. The low yield from the taxes on the ownership of wealth and its transfer has been a matter of common knowledge ever since they were levied in India. The yield from these taxes as a percentage of total revenue from direct taxes of the Central Government has declined over the years. The main reason for this declining revenue importance of taxes on wealth has been the erosion of tax bases by exemptions, deductions and allowance. If there is any successful tax planning in India, it has been in the field of taxation of wealth. A doubt arises whether the taxes were really intended to be seriously applied for the purpose of reducing inequality of wealth at all!

In the case of wealth-tax, the device of gift-making has reduced the tax base enormously. ... Further, gift-making is also used to avoid estate

duty. The device of splitting the wealth in the upper brackets has also increased, particularly in the case of HUFs. Although the total number of HUFs increased from 2,345 to 7,027 during he period between 1961-62 to 1976-77, there occurred significant number of assessees belonging to lower bracket of wealth, thereby proving the suspicion that the assessee in the upper brackets resorted to splitting up of their wealth to minimize the tax burden. Besides, there has been widespread evasion of tax through the creation of private trusts and transfer of assets to companies.

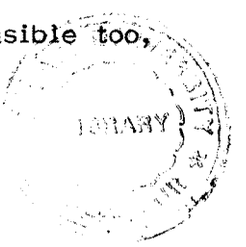
The main purpose of levying all the three taxes was to catch the wealth owner at least by any two of the three acts of owning, bequeathing and gifting. But it is possible to escape from all the three taxes. If caught, at worse, he may have to pay only nominal tax under gift tax by proper tax planning. This is mainly because of generous deductions and disparity in the rate structure of these taxes.

It is frequenly maintained that the inequality in the distribution of wealth is higher than the inequality in the distribution of income. ... This is mainly because of the feudal past which has persisted into the present. The emergence of the 'black money' has further perpetuated it. Against this, the equalization effect of these direct taxes has been negligible, ... It may be observed that that all these three taxes have proportional incidence which means the socio-political objective of these taxes, namely, reduction of inequalities of wealth, has been defeated. ... Therefore, it is necessary to bring about some reform in the existing structure of taxation of wealth in India with a view to achieving the avowed objectives.

Suggested Reform of Taxation of Wealth:

One probable solution would be to ***reduce*** *numerous* ***deductions and allowances*** *to a minimum and* ***equalize*** *the* ***exemption limits and*** *the* ***rate structure*** *for all the three taxes. This is not a practicable package of reforms, because the gift tax cannot be treated on par with estate duty or wealth-tax because of the amount of tax base and rates of tax involved. Therefore, the rate structure will have to be different for wealth tax and gift tax and also for estate duty and gift tax. In view of this practical problem, a more practicable solution would be to reduce the deductions and allowances under the wealth tax to a minimum and replace the existing estate duty and gift tax by one single tax on the transfer of the type of capital transfer tax prevailing in U.K. This new tax will make it possible to check evasion of wealth tax and estate duty through gifts. It will enable the government to equalize the rate structure of wealth tax and assets transfer ax. The exemption limit for the assets transfer tax may be fixed at Rs.5000 annually with a cumulative maximum life time exemption limit of Rs.1.50 lakhs. And all the transfers made in one's life time will have to be aggregated at the time of assessing an assessee for assets transfer tax. Whenever the value of his assets transferred exceeds the exemption limit, he becomes liable for this assets transfer tax.*[4]

There had been an oft-repeated demand from various quarters to totally abolish the tax on wealth because of the loopholes it provides to an assessee to escape from the total tax net. Short of such a drastic measure of scrapping the duly enacted legislation, it would be advisable, and more feasible too,



to review the exemptions provisions, that is the whole of section 5, with a view to make them more realistic and concurrent with the contemporary socio-political and socio-economic objectives, if not of achieving socialistic pattern of society in the immediate future.

REFERENCES

1. K.Chaturvedi and S.M.Pithisaria : "Three Taxes", 1989 Edn., pp.146.
2. Ibid.
3. Ibid., p.147.
4. Thimmiaih, G. : "Perspectives on Tax Design and Tax Reforms", p.129, 132-4.

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