

## **CHAPTER II**

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### **INTRODUCTION**

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2.1 HISTORICAL BACKGROUND OF DIRECT TAXES  
AND GIFT TAX

Direct taxation in its modern form in India has a history of about 125 years, the first legislation having been first introduced in the year 1860, which was the first attempt to enforce tax on income. The main objective of this levy was to raise revenue for the Government. With the change in the socio-economic and political situation, especially after independence, taxation has come to acquire an important place in the fiscal armoury of the Central Government and it is intended to achieve variety of socio-economic objectives in addition to mobilisation of the resources for the Government. The latest legislation for levy of tax on income was introduced in the year 1961/62 and the entire Income-tax legislation prior thereto was introduced as Income-tax Act, 1961, which came into force from 1.4.1962 and this basically repealed the Income-tax Act, 1922. The Estate Duty legislation was introduced in the year 1952, although it has been abolished since 1985. In addition, the Expenditure Tax was introduced but was abolished in the year 1966. Similarly, Gift Tax Act, 1958 and Wealth Tax Act, 1957 were also introduced by the Govt. of India. All these legislations were introduced with a view to bring into force the integrated tax structure based

primarily on the recommendations of the Report of Prof. Kaldor.

The Gift Tax Act, 1958 was introduced with effect from 1.4.1958. The said Act extended to the whole of India except the State of Jammu and Kashmir and was primarily intended to arrest the possibilities of tax evasion or avoidance. The taxable entities were precisely defined under Section 2 of the said legislation and they included an individual, a Hindu undivided family, a company, an association of persons or body of individuals whether incorporated or not.

## 2.2 OBJECTIVES AND REASONS BEHIND THE LEGISLATION RELATING TO GIFTS

The tax on gift was altogether a new innovation in the fiscal history of India. The enactment was introduced from 1.4.1958 and the main thrust was on the evasion of taxes through gifts. As such, the Gift Tax legislation affected substantially the various other related Direct Taxes such as Estate Duty, Wealth Tax, Income-tax and Expenditure Tax. The tax on gift was aimed at achieving an integrated tax structure. The main purpose behind the legislation as declared in the Lok Sabha was as under:

"Gift is an important tool of avoiding tax or reducing tax liability. With

the commencement of this legislation, it is difficult for a person to avoid taxes through transfer of property by virtue of gifts. The gifts are voluntary disposition of property conferring bounty or benefit on the donee. The taxable gifts are chargeable at the rates specified by the Finance Act."

The Direct Taxes imposed by the Union Government have a definite role to play in the overall fiscal scheme. The primary function of Direct Taxes is to generate revenues for the Union Government. At the same time, they are intended to eliminate, as far as possible, or minimise to the extent possible the income or wealth disparity. As such, the socialistic Government have introduced this legislation with a view to achieve socio-economic objectives, more particularly the tax on gifts achieves this purpose as any possible evasion of taxes on estate or wealth or income is reduced to a substantial extent and any dispositions or transfers are roped within taxable area making an individual a difficult task for evading taxes.

The Direct Taxes in India have a primary function to play and as such these functions are achieved by levying tax on income under Income-tax Act, tax on wealth under Wealth Tax Act, tax on expenditure under Expenditure Tax Act and tax on estate under Estate Duty Legislation. However, the overall purpose cannot be achieved unless the gifts are also covered. The introduction of Gift Tax Act, 1958, therefore, positively arrested all possibilities of

tax evasion and the first attempt, therefore, was made to plug the loopholes which were left unchecked. Thus, the integrated tax structure came into force by introducing for the first time the Gift Tax legislation.

It can be seen that there are number of countries in the world like United States of America, Canada, Japan, Australia and New Zealand, where the Gift Tax legislation does exist. The pronounced need for such legislation was felt in India as in the absence of Gift Tax legislation, the rampant tax evasion would not have been brought to a halt. Therefore, the levy of tax on gift assumes high significance as it serves a very vital objective in arresting loopholes in the tax system.

In addition to the above objective, the Direct Taxes are aimed at restraining or curtailing conspicuous consumption such as enabling the Government from transferring resources from consumption to investment, enlarging the areas of incentives to save and invest enabling further the Government machinery to widen the scope of public investment and channelising such investment in appropriate areas. Besides this, reduction of income and wealth inequalities is to a large extent achieved through these legislations. In fact, the tax policy of any country is intended directly or indirectly to achieve various objectives. Collectively taken together, in addition to resource mobilisation, the objective relating to reduction of income and wealth disparities

assumes significant position in the background of socio-economic conditions prevailing in our country. All these objectives are sought to be achieved through sustained efforts and as such a suitable fiscal policy requires the Government to achieve all these objectives through systematic harmonious and simplified efforts. The need for such fiscal policy in a developing country like India has assumed more significance in view of the economic poverty prevailing in our country.

### 2.3 INTEGRATED SCHEME OF TAXATION

Prof. Nicholas Kaldor, at the instance of the Govt. of India, investigated the overall tax structure some time in January, 1956 and in his Report presented to the Govt. of India, strongly recommended the introduction of an integrated tax structure. The three new taxes, namely Wealth Tax, Gift Tax and Expenditure Tax, therefore, had their genesis in such recommendations.

## 2.4 THE CONCEPT OF 'GIFT' - DEFINITION, Etc.

The term 'Gift' has been defined under Section 122 of the Transfer of Property Act and it means -

"Gift is the transfer of certain existing movable and immovable property made voluntarily and without consideration, by one person, called the donor, to another person called the donee, and accepted by or on behalf of the donee"

This is the definition provided under the Transfer of Property Act. However, the definition of the term 'Gift' has been substantially varied under the Gift Tax Act, 1957 and under Sec.2 (xii) the term 'Gift' has been defined as -

"Gift means the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth and includes the transfer or conversion of any property referred to in Section 4, deemed to be gift under that Section"

The meaning assigned to the term 'Gift' under the laws of various other countries has been more or less the same.

The Canadian Gift Tax defines the term 'Gift' as under:

"Gift includes a transfer, assignment or other disposition of property (whether situated inside or outside Canada) by way of gift and without limiting the generality of the foregoing, includes (1) the creation of a trust of or interest in, property by way of gift and (2) a transaction or transactions whereby a person disposes of property directly or indirectly by way of gift."

Similarly, the New Zealand Estate and Gift Duties Act defines the term as

"Any disposition of property which is made otherwise than by will, whether with or without instrument in writing, without full adequate consideration, in money or money's worth"

The Australian Gift Tax Act defines the term 'Gift' as under:

"Gift means any disposition of property which is made otherwise than by will (whether with or without instrument in writing) without consideration any money or money's worth passing from the donee to the donor"

From the above various definitions adopted in different countries, it can be observed that the meaning assigned to the term 'Gift' under the Gift Tax Act, 1957, is exhaustive and excluded any meanings other than ascribed. The definition of the term involves two distinct types of separate enquiries. The existence of a transfer of property must be first ascertained and then the extent of consideration given. The first leg of enquiry is whether there is a transfer of property and thereafter there is a question of the adequacy of any consideration. Similarly, the second leg pertains to whether there is any consideration in money or money's worth.

The gifts under the Indian condition involve three



distinct types of gifts:

- (1) Gifts inter vivos
- (2) Gifts mortis causa and
- (3) Gifts by will

The Gift Tax Act brings into operation gifts inter vivos.

The above definition implies certain basic prerequisites to a constitute a particular transfer into a gift. Therefore, it is necessary to examine the essentials of a gift. Firstly, the definition implies that there must necessarily be a transfer of property; secondly, a transfer in the normal sense of term presupposes an act between two parties, i.e. the transaction must be bilateral. The third essential is there must be a gratuitous grant. Fourthly, there must be a donor and the donee. Similarly, there must be a transfer without consideration of certain existing movable or immovable property and finally, the Act covers within its scope the deemed gifts falling under Section 4 of the Gift Tax Act, 1957.

From the above examination of the definition of the term 'Gift', it can be concluded that in order that any transfer falls within the definition of the gift, the essential requirements must be satisfied which means that in order to constitute a valid gift, all these essential conditions of the definition of the term 'Gift' must be satisfied, failing which the particular transfer would not fall within the

definition of the gift as a consequence of which there would not be a liability arising under the Gift Tax Act. Therefore, in order to fix the statutory incidence it is essential to establish that the transaction does fall within the meaning of the term 'Gift' and that too the meaning assigned under the Gift Tax Act is of vital significance rather than the meaning assigned to the term 'Gift' under the Transfer of Property Act.

It can further be seen that the definitions of the term 'Gift' covers within its scope all types of property, movable as well as immovable. This assumes further significance because certain intangible property would also be covered under the definition, for instance, interest in property, goodwill, copy rights, patents, trade marks, etc. Therefore, the statutory meaning assigned to the term 'Gift' is very broad and exhaustive and thus covers within its scope innumerable transactions - tangible or intangible, movable or immovable, the present interest or even in certain cases likely interest in the property.

## 2.5 DONOR

The second significant definition requiring thorough understanding is the term, 'Donor' as defined in Section 2 of the Gift Tax Act, 1957. It means any person who makes a gift. A person making a gift is termed as a 'donor' under the

Act. However, the meaning assigned to the term 'donor' under Section 7 of the Transfer of Property Act provides that

"Every person competent to contract and entitled to transfer property or authorised to dispose of transferable property not his own is competent to transfer such property."

Consequently, any person who sui juries is capable of making a gift of his property is a donor. Therefore, the competency to contract or any alienated property determines the power of making gift and the person enjoying this power can be a donor. It is a well recognised principle that a 'Karta' of a Hindu Undivided Family can be a donor. Likewise, a company established under the law can also be a donor. Similarly, a trustee under the law can be also a donor. In addition to this, Section 4 of the Gift Tax Act enumerates certain transfers and transactions as deemed gifts. Accordingly, under this deeming notion, there may be also deemed donors. However, the absence of competence to contract changes the entire position as a minor being incompetent to contract, is incompetent to make a gift. Likewise, a lunatic or judgement debtor cannot be a donor. In order that a particular transaction falls within the meaning of the term 'gift' there must necessarily be a donor and the donee. Thus, the 'donor' has been defined by the Act itself.

2.6 DONEE

The term 'Donee' under the Act under Section 2 is also defined and it means any person who acquires any property under a gift and where a gift is made to a trustee for the benefit of another person, includes both the trustee and the beneficiary. This definition is also differently worded under the Transfer of Property Act which means,

"Gift is a transfer to another person called the donee and accepted by or on behalf of the donee."

However, under the Gift Tax Act, the donee is

"Any person who acquires any property under the gift"

Therefore, there must necessarily be two parties to a gift, namely, a giver and secondly a receiver, i.e. a transferer and a transferee and in legal significance under the Gift Tax Act, these are recognised as donor and donee. It has been specifically explained under the law that any living person except a legally disqualified one can be a donee, i.e. a minor or any other incapacitated person can also be a donee. As such any woman can also be a donee, because a guardian may accept gift in case of a minor or on behalf of incapacitated person. However, if on the date of gift, donee is not alive, the gift lapses. The notional concept under Section 4 also implies deemed donee under the Act. Thus, a person who is a

beneficiary in transfer or transaction would be deemed donee where transfer of property is otherwise than adequate consideration or for intended consideration or where the transfer is of release, discharge, surrender, forfeiture or abandonment of any debt, contract or other claim or interest in property held as not bonafide. Similarly, after 1.4.1972, conversion of separate property into that of H.U.F. property would be treated as a deemed gift.

## 2.7 DEFINITION OF 'TRANSFER'

The term 'Transfer' assumes high significance for the purpose of levy of tax on gifts. Sec. 2 (xxiv) of the Act defines the term 'Transfer of Property' as under:

"Transfer of property" means any disposition, conveyance, assignment, settlement, delivery, payment or other alienation of property and, without limiting the generality of the foregoing, includes -

- (a) the creation of a trust in property;
- (b) the grant or creation of any lease, mortgage, charge, licence, power, partnership or interest in property;
- (c) the exercise of power of appointment (whether general, special or subject to any restrictions as to the persons in whose favour the appointment may

- be made) of property vested in any person, not the owner of the property, to determine its disposition in favour of any person other than the donee of the power; and
- (d) any transaction entered into by any person with intent thereby to diminish directly or indirectly the value of his own property and to increase the value of the property of any other person;"

The term 'Transfer' has also been defined under Income-tax Act under Sec.2 (47). However, the different meanings assigned to the terms are intended to serve different statutory objectives. Basically under the Gift Tax Act the 'Gift' implies 'transfer of property' and without such transfer there is no gift. The term 'Transfer' under the Transfer of Property Act means 'an act by which a living person conveys property in present or in future to one or more other living persons or himself.' Therefore, the term 'Transfer' in relation to Gift Tax provisions assumes wider significance as it covers within its scope different types of dispositions. A noted Authority on Gift Tax, Mr.C.A.Gulanikar in his commentary furnishes the following comment on the term 'Transfer' as under:

" (b) Sec.58 (e) The Canadian Income Tax Act  
(Gift Tax):

"Disposition includes any arrangement or ordering in the nature of a disposition, whether by one transaction or a number of transactions, effected for the purpose of or in any other manner, whatsoever.

Sec.3 (6): Other disposition:

(a) General power exercised by donee:

The exercise by a person during his lifetime of any general power of which that person was donee or other holder shall be deemed to be a disposition made by the person at the time of the exercise of the power, and, in relation to any such disposition, the expression 'property' in this Act includes the benefit conferred by the exercise of the power:

(c) Sec.2511 : United States Gift Tax:

Transfers in general:

(a) Scope: "Subject to the limitations contained in this Chapter, the tax imposed by Section 2501 shall apply whether the transfer is in trust or others, whether the gift is direct or indirect."

- (d) Sec.4 : Australian Gift Duty Assessment Act:  
'Disposition of property' means any conveyance, transfer, assignment, settlement, delivery, payment or other alienation of property and without limiting the generality of the foregoing, includes:
- (a) the allotment of shares in company;
  - (b) the creation of a trust in property;
  - (c) the grant or creation of any lease, mortgage, charge, servitude, licence, power, partnership or interest in property;
  - (d) the release, discharge, surrender, forfeiture or abandonment, at law or in equity, of any debt, contract, or chose-in action, or of any interest in property;
  - (e) the exercise of appointment of property in favour of any person other than the donee of the power;
  - (f) any transaction entered into by any person with intent thereby to diminish, directly or indirectly, the value of his own property and to increase the



value of the property of any other person.

(e) Sec. 39 - New Zealand Gift Tax Duties Act:

Disposition of property means -

- (a) any conveyance, transfer, assignment, settlement, delivery, payment or other alienation of property, whether at law or in equity;
- (b) the creation of trust;
- (c) the grant or creation of any lease, mortgage, charge, servitude, licence, power, or other right, estate, or interest in or over any property, whether at law or in equity;
- (d) the release, discharge, surrender, forfeiture, abandonment of any debt, contract, or chose-in action or of any right, power, estate or interest in or over any property, and for this purpose a debt, or any other right, estate or interest, shall be deemed to have been released or surrendered when it has been irrecoverable enforceable or through the lapse of time;

- (e) the exercise of a general power of appointment in favour of any person other than donee of the power;
- (f) any transaction entered into by any person with intent thereby to diminish, directly or indirectly, the value of his own estate and to increase the value of the estate of any other person."

From the above comment and the text of the definition of the term 'Transfer', it is observed that vast transactions are covered within the meaning of the term 'Transfer'.