

Inland Revenue Department
Hong Kong
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ESTATE DUTY OFFICE
INTERPRETATION & PRACTICE NOTES
NO. 1
CONTROLLED COMPANIES PROVISIONS
UNDER THE ESTATE DUTY ORDINANCE (CAP.111)

These notes contain a summary of the Departmental interpretation and practice and are issued for general information and guidance only. They have no binding force and do not affect a person's right of appeal to the Courts.

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Commissioner of Inland Revenue

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Estate Duty Office Interpretation and Practice Notes No. 1

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INTRODUCTION

1. The Estate Duty Ordinance, Cap. 111 (the Ordinance) imposes estate duty on the principal value of the estate of a deceased person. There is some misconception that an individual can avoid the estate duty levy by transferring and holding assets through the use of corporate vehicles which would have perpetual existence while continuing to enjoy income from the company during his lifetime. With the enactment of the anti-avoidance provisions on controlled companies in the Ordinance in 1959, an individual could hardly be able to do so. By virtue of section 35 of the Ordinance, in certain circumstances, a proportion of the Hong Kong assets of a controlled company is deemed to be included in the property passing on the death of a deceased and is therefore chargeable to estate duty. The purpose of this Practice Note is to set out the Department's views and practice on the application of the controlled companies provisions and to address the issue on the compliance of reporting obligations under such provisions.

2. The so-called controlled companies provisions are contained in sections 34 to 45 of, as well as Schedule 2 to, the Ordinance. Section 34 defines the meaning of controlled company. Section 35 imposes an estate duty charge on certain assets of a controlled company from which benefits accrued to the deceased in the 3 years ending with his death. Section 36 expands the meaning of "benefits" for the purpose of section 35. Section 37 makes provisions for the calculation of surrendered benefits. Section 38 specifies how the net profits of a controlled company are to be ascertained. Section 39 disallows certain liabilities in calculating the assets of a controlled company. Section 40 limits the charge of estate duty in certain rare circumstances. Section 41 provides that certain exceptions to estate duty liability shall not apply in the case of a controlled company. Section 42 imposes a duty on the controlled company and its directors to report information regarding the deceased to the Commissioner of Estate Duty (the Commissioner). Section 43 provides for the collection and incidence of duty payable by virtue of section 35. Section 44 provides for a special method of valuation in respect of shares and debentures owned by the deceased in a controlled company. Section 45 provides that certain dispositions through a controlled company in favour of relatives are to be deemed to be property passing on the death of the deceased who controlled such company.

3. Schedule 2 contains provisions supplementary to sections 34 to 45 of the Ordinance. It covers the following topics, viz. (i) amount to be taken into account in respect of benefits, and time when benefits are to be treated as accruing; (ii) adjustments as to distributed assets and additions to assets; (iii) prevention of duplication of charge in respect of benefits and charge in respect of shares; (iv) accounting year; and (v) grant of prior assurances.

DEFINITION OF “CONTROLLED COMPANY”

The Definition

4. A *controlled company* is defined in section 34(1) of the Ordinance as “any company which, at any relevant time, is deemed to have been under the control of not more than 5 persons not being a company which, at any such time, is deemed to have been either a subsidiary company or a company in which the public were substantially interested”. It should be noted that the qualifying words “not being” refer to the company which is under consideration and not the “5 persons”, or any of them, immediately preceding such words.

5. Therefore, in order to determine whether a company is a controlled company within the meaning of the Ordinance, the following tests shall apply -

- (a) whether the company is deemed to have been under the control of not more than 5 persons at any relevant time; and
- (b) whether the company, at any such time, is either a subsidiary company [*as defined*] or a company in which the public were substantially interested.

Where the answer to test (a) is in the affirmative *and* that to test (b) in the negative, the company is a controlled company. Any other combinations of the answers would result in the company not being a controlled company.

6. The following interpretations apply to the terms appearing in the definition of “controlled company” -

- (a) “company” – it includes any body corporate, wherever incorporated [section 3(1)];
- (b) “relevant time” – it is defined in section 34(7) as -
 - (i) for the purpose of section 44, any time during the period beginning 3 years prior to the death of the deceased and ending with such death; and
 - (ii) for the purpose of sections 35 [see paras. 15 to 19], 41 and 45, any time between the date of transfer of the property and the date of death of the deceased;

- (c) “control” – under section 34(2), a company shall be deemed to be under the control of not more than 5 persons -
- (i) if any 5 or fewer persons together exercise, or are able to exercise, or are entitled to acquire, control, whether direct or indirect, over the company's affairs, and in particular, but without prejudice to the generality of the foregoing words, if any 5 or fewer persons together possess, or are entitled to acquire, the greater part of the share capital or voting power of the company; or
 - (ii) if any 5 or fewer persons together possess, or are entitled to acquire, either the greater part of the issued share capital of the company, or such part of that capital as would, if the whole of the profits of the company had been in fact distributed to the members, entitle them to receive the greater part of the amount so distributed; or
 - (iii) if in any relevant accounting year, more than half of the profits of the company have been, or could have been, apportioned among not more than 5 persons; or
 - (iv) if any 5 or fewer persons would, if the company were wound up, be entitled as members or loan creditors of the company to receive more than half of the assets of the company which would be available for distribution to members and loan creditors;
- (d) “not more than 5 persons” – section 34(3) provides that *persons* in any one of the following classes shall be treated as a single person with other persons of that same class -
- (i) persons who are relatives of one another;
 - (ii) nominees of another person together with that person;
 - (iii) persons in partnership within the meaning of section 3 of the Partnership Ordinance (Cap. 38); and
 - (iv) persons interested in any shares or obligations of the company which are subject to any trust or are part of the estate of a deceased person;

It is therefore possible for a company to fall outside the definition of “controlled company” by having a minimum of ten independent shareholders all having an equal shareholding and none with a casting vote in the event of an equality of votes.

- (e) “a subsidiary company” – it refers to a subsidiary company the holding company of which is not itself a controlled company, or where there are 2 or more holding companies, none of them is a controlled company [section 34(5)(a)]; and
- (f) “a company in which the public were substantially interested” – it refers to a company in which at least 25% of the voting power is held by members of the public in the form of shares listed on the Unified Exchange, i.e. the Stock Exchange of Hong Kong Ltd. [section 34(5)(b)].

Concessionary Treatment

7. With respect to test (b) in para. 5 above, it should be noted that a company will satisfy that test if and only if it is a subsidiary company or a company in which the public were substantially interested *at any relevant time*, i.e. at any point in time during the period of the “relevant time”. In other words, it has to be a company of the kind referred to *throughout* the entire relevant time. This requirement could be rather stringent where the relevant time concerned is a relatively long period.

8. Notwithstanding para. 7 above, the Department notes that a corporate structure is commonly used as a vehicle to carry on business in Hong Kong and there are often good reasons for transferring assets to such vehicles. The Department therefore takes a liberal approach in determining whether a company is a controlled company within the meaning of section 34(1). In practice, in a case where the relevant time exceeds 3 years, the Department accepts that the company concerned falls outside the scope of the section if it has been a subsidiary company, or one in which the public were substantially interested, throughout the period of *3 years* immediately prior to the date of death of the deceased.

9. It is understood that there have been cases whereby companies have diluted their shareholding to the public within the three years period followed by a public offering without disclosing in the accounts the contingent estate duty liability that may technically be imposed under section 35. Recognizing that in most of such cases the dilution of shares is not for avoidance of estate duty, the Commissioner is willing to grant an extra concession that section 35 would not be applied to those companies. However, this extra concession will not be applicable to companies carrying out dilution of shares after the issue of this Practice Note.

Illustration

10. The following example illustrates the application of section 34(1) -

Example 1

Mr. A, the controlling shareholder of X Co. Ltd., transferred his residential property to the company on 1 January 1990. Then on 1 January 1994, X Co. Ltd. was listed on the Stock Exchange which requires that at least 25% of the shares are to be held by the public. Mr. A continued to be a director of the company. He eventually died on 31 December 1999.

11. To apply test (a) in para. 5 above, we have first to determine what is the “relevant time”. By virtue of section 34(7), this means any time during the period ending on the death of the deceased and beginning with the transfer of property to the company [see para. 6(b)(ii)]. In this example, it refers to any point in time during the period of 10 years from 1 January 1990 (date of transfer of property) to 31 December 1999 (date of death of the deceased).

12. Next, we have to ascertain whether at any point in time during the aforesaid 10-year period the company was controlled by not more than 5 persons. Apparently, this was the case since Mr. A was the controlling shareholder of the company (i.e. the company was controlled by just one person) at the time of the subject transfer until 1 January 1994 when the company was listed. Therefore, test (a) is in the affirmative.

13. Thirdly, we have to consider test (b) in para. 5 above. On 1 January 1994, X Co. Ltd went public and at least 25% of its shares must be held by the public according to the requirements of the Stock Exchange. Thus, the company could be regarded as one in which the public were substantially interested [see para. 6(f)] with effect from that date. The question, however, is whether the company was such a publicly-interested company *throughout the relevant time*, i.e. throughout the 10-year period from 1 January 1990 to 31 December 1999 [see para. 7]. The answer would obviously be in the negative. However, by virtue of the concession as per para. 8 above, since the company was, during the *3 years immediately prior to the death* of Mr. A, a company in which the public were substantially interested, the answer to test (b) will be regarded by the Department as being in the affirmative.

14. The above analysis shows that the answer to test (a) is in the affirmative but that to test (b) is also in the affirmative. Therefore, the Department will NOT regard X Co. Ltd. as a controlled company within the meaning of the Ordinance.

DUTY ON ASSETS OF CONTROLLED COMPANIES

15. Section 35 provides that under certain circumstances, the Hong Kong assets of a controlled company are deemed to be property passing on the death of a deceased person and thus liable to estate duty. The circumstances, or the pre-requisite conditions, for invoking section 35, are -

- (a) the company is a controlled company within the meaning of section 34(1);
- (b) there is a transfer of any property¹ to the controlled company at any time during the lifetime of the deceased by *any* person (see para. 16 below), other than property which he transferred in a fiduciary capacity (see para. 20 below); and
- (c) there are benefits accruing to the deceased from the company during the 3 years ending with his death.

16. According to the plain words of the section, the provisions could apply if *any* person transfers assets to a company. However, such an interpretation would have very wide implications and may not be within the intent of the legislature. Hence, in practice, the Department will not invoke section 35 if the transfer of property was *not made* by the deceased and the deceased *never had any beneficial interest* in the property transferred.

17. Where all the three conditions above are satisfied, a proportion of the assets of the controlled company in Hong Kong shall be deemed to be property passing on death [section 35(1)]. The proportion of assets deemed to accrue to the deceased is determined by reference to the proportion that the aggregate benefits accruing to the deceased from the company in the last three *accounting years* bears to the aggregate net profits of the company during the same period [section 35(2)]. The following formula is to be applied -

Aggregate amount of benefits accruing to the deceased in the 3 accounting years before death		The company's
Aggregate amount of net profits of the company for the same period	x	Hong Kong assets

¹ The word "property" is defined in section 3(1) of the Ordinance to include movable and immovable property and the proceeds of sale thereof respectively and any money or investment for the time being representing the proceeds of sale.

18. The term “accounting year” is defined in paragraph 6 of Schedule 2 to the Ordinance. Generally, it refers to the period of 12 months, in which the company’s accounts are made up, ending in the last year of the death of the deceased. For example, if the date of death is 30 June 1999, the last year of the death of the deceased is the period from 1 July 1998 to 30 June 1999. Therefore, any accounting year ending on a date within this period is the last “accounting year”. This accounting year together with the 2 previous accounting years will constitute the “last three accounting years”.

19. Where the controlled company has suffered a loss in any of the relevant accounting years, the loss is to be deducted in computing the aggregate net profits² of the company for these years [section 35(2) proviso (a)]. Where a controlled company has both Hong Kong and overseas assets, only those Hong Kong assets are to be included as estate duty is charged only on property situate in Hong Kong [section 10(b)].

Transfers of Property to a Company

20. In deciding whether a person has made a transfer of any property to a company for the purpose of section 35, the definitions and special meanings given to the term “transfer of property” [sections 3(3)³ and 3(5)(d)⁴] should be particularly noted. Strictly speaking, the meaning of this term is so wide that section 35(1) may be applied even to a genuine arm’s length transaction. However, in practice, the Department will not invoke section 35 if the transfer of property was in reality a genuine arm’s length transaction for full consideration in money (even if the transfer was made by the deceased). One such example is the transfer of a landed property to a company by a third party (the vendor) as a result of the payment of purchase consideration in cash at market price by the company.

Meaning of Benefits

21. The Ordinance specifies that the “benefits” from a controlled company

² Where the aggregation resulted in a loss, *all* of the company’s Hong Kong assets will be deemed to be property passing on death. The same applies where the aggregate net profits is less than the aggregate amount of the benefits accruing to the deceased.

³ Under section 3(3), a person shall be deemed to have made a transfer of property to a company if the property came to be included in the resources of the company by the effect of a disposition made by him or with his consent or of any associated operations of which such a disposition formed one.

⁴ Under section 3(5)(d), a reference to a transfer of property, (except in the definition of “payment” in subsection (1)) shall include a reference to a payment of money, and the expressions “disposition” and “value” respectively, in relation to money, shall include payment and amount.

shall include -

- (a) actual benefits [section 36(a)]
 - (i) any profits of the company received by the deceased, directly or indirectly, for his own benefit;
 - (ii) any periodical payment made for the benefit of the deceased, directly or indirectly, out of the company's resources or at its expense;
 - (iii) any enjoyment in specie of land or any other property of the company which the deceased had for his own benefit, directly or indirectly;
- (b) potential benefits
 - (i) any such profits, payment or enjoyment as aforesaid which the deceased was entitled to receive [section 36(b)];
 - (ii) any such profits, payment or enjoyment as aforesaid which the deceased could have been entitled to receive within the three years before death if the relevant power had been exercised [section 36(c)];
- (c) notional benefits
 - (i) interest at the average rate [section 36, 2nd limb];
 - (ii) surrendered benefits [section 37(1)];
 - (iii) benefits deemed to be received under section 3(4) ⁵; and
- (d) imputed benefits [Schedule 2, paragraphs 1(3) ⁶ and 1(4) ⁷].

⁵ Generally, section 3(4) deems a person to have received or had any payment, etc. that has been applied to any manner for the benefit of that person, or if that person become able to control the application of such payment, etc.

⁶ Where an amount is taken into account by reference to the deceased's having been entitled to a benefit which he did not in fact receive, or by reference to a power which was not in fact exercised or was surrendered, due regard shall be had to the effect that his receiving the benefit, or the power's being exercised, would have had in relation to other benefits.

⁷ The amounts that are to be taken into account by reference to the deceased's having been entitled to a benefit which he did not in fact receive, or by reference to a power which was not in fact exercised or was surrendered, shall be such as would have fallen to be taken into account as benefits received by the deceased if he had acted in relation to the claiming to benefits and the exercising of powers during the 3 years ending with his death to his greatest financial advantage, due regard being had to any consideration which he would have had to give in respect of a claim to any benefit or the exercise of any power.

22. That part of the benefits mentioned in section 36 [see paragraphs 21(a), 21(b) and 21(c)(i)] which, in the opinion of the Commissioner, represents reasonable remuneration made to the deceased for any services rendered by him as the holder of an office in the company, shall not be treated as a benefit [section 40(9)]. Besides, it is the Department's practice that benefits received by a person in respect of an arm's length transaction made on normal commercial terms from a company in which he has no control at the time of receipt of the benefits will not be treated as "benefit" for the purposes of sections 34 to 45.

23. The detailed rules for determining the amounts to be taken into account in respect of benefits accruing to a deceased are set out in Schedule 2 to the Ordinance.

24. The following examples illustrate the kind of benefits to be taken/not to be taken into account.

Example 2

Mr B rents a flat at market rent from Company R in which he has no control whatsoever.

The occupation of the flat is technically a benefit received from Company R. However, as the lease of the flat is at market rent (i.e. on normal commercial terms) and the benefit is from a company in which Mr B has no control, the occupation of the flat will not be treated as a benefit for the purposes of sections 34 to 45. Company R would not fall within the controlled companies provisions simply because of this transaction.

Example 3

Mr C, in the capacity as an ordinary customer, places deposit with Bank S.

Technically speaking, the placing of a deposit in return for periodic payments of interest is a transfer of property for a benefit. Since the deposit and payment of interest is performed under a normal commercial transaction (i.e. a bank and its customer), the bank would not be regarded as a controlled company and the periodic payments of interest would not be a benefit for the purposes of sections 34 to 45, whether or not Mr C has control over the bank.

Example 4

Mr D, an employee of Company T, in pursuance of a share incentive scheme under the terms of employment, holds a small number of shares in Company T.

The application of shares under a share incentive scheme and the enjoyment of dividends on the shares so allotted technically amount to transfer of property with enjoyment of benefit. However, as share incentive schemes are common incentives to employees for loyalty and performance of quality service to the company, it is unrealistic to presume that such arrangement is for avoidance of estate duty. It follows that the controlled companies provisions would not be applied to Company T.

DEPARTMENT'S VIEW ON THE APPLICATION OF SECTION 35

25. The section 35 charge is modelled on section 46 of the United Kingdom Finance Act 1940 which was designed to counteract avoidance of estate duty through the use of controlled companies. Similar to its UK equivalent, the scope of section 35 charge is so wide that theoretically it can catch many innocent transactions. Moreover, this charge has also been criticized for its complexity.

26. The Commissioner has seldom invoked the controlled companies provisions since their enactment in 1959. In fact, when section 35 was first introduced, it was pointed out that the section was drawn in terms that went beyond what was required to tackle anti-avoidance schemes. The then Financial Secretary made an assurance statement to the public that this complicated provision would only be invoked where there was an element of evasion. The Financial Secretary also reconfirmed the policy in his speech in the Legislative Council on 29 March 1963 -

“.....But I think it important to understand that the purpose of these provisions is to prevent tax evasion, not to catch legitimate transactions; and the Commissioner has discretion both as to its invocation and as to its application which is sufficient to ensure that legitimate transactions are not caught by it.....”.

27. Although the Financial Secretary used the phrase “element of evasion”, in essence he was referring to an “element of avoidance”, that is, the planning of affairs with the purpose of avoidance of estate duty rather than the illegal evasion by the concealment of true facts. Support to this view can be found in paragraph 7 of Schedule 2 to the Ordinance which empowers the Commissioner to issue a prior assurance for not invoking section 35 where he is satisfied that a transfer of property was not for the purpose of *avoiding* estate duty. On this understanding, it has been the Department's policy to invoke the controlled companies provisions only where there is patently an attempt to avoid estate duty, especially where the transaction is contrived, artificial and undertaken purely for tax avoidance reasons without any other

purpose. A transfer undertaken for legitimate family and commercial purposes will generally be acquiesced albeit with regard to the least possible exposure to tax liability. One such example is the re-organization of family assets to guard against a take-over bid.

28. It must be appreciated that it is difficult to draw a clear distinction between those cases where the controlled companies provisions should be applied and those where such provisions should not be applied. The primary test is that the Commissioner has to satisfy himself that the transfer was made with a paramount intention to avoid estate duty. Again, to establish such an intention in any case, the facts of each case have to be examined on individual merits. By analogy, the question to be asked is whether the transfer is equivalent to a gift with reservation of benefits. The following is an example -

Example 5

Mr E transferred his residential property to an investment company, which had no other valuable asset of its own apart from Mr E's property. Mr E continued to occupy the property rent-free as his residence after the transfer until his death 10 years later.

Apparently, the retention of the property by Mr E as his residence is a reservation of benefit. The transfer of the property from Mr E to the company is therefore regarded as "a gift of property with a reservation of benefit" and therefore triggers the application of section 35.

29. In practice, the controlled companies provisions will not be invoked if the deceased's financial interests in the company to which he genuinely transferred the property are fairly reflected in the value of his shareholdings in the company and such interests are subject to Hong Kong estate duty. It should be noted that these provisions were designed to counteract avoidance of estate duty through the vehicle of controlled companies and not for the purpose of generating revenue.

30. In the course of examination of the estate duty affidavits and accounts, it has been the Department's practice to examine primarily the transactions effected within the three years immediately prior to the death of the deceased. However, where it is uncovered that companies have been used as vehicles to avoid estate duty, all transfers of property from the deceased to the companies will be examined in depth though such transfers might have been concluded outside the three year period.

Actual Cases in Which Section 35 Was Invoked

31. Section 35 was invoked in the following actual cases -

Case 1

The deceased transferred his assets into an offshore controlled company with which he maintained a current account. The transfer of the assets were effected through a series of transactions. The interest payable on the credit balance of the current account was not demanded by the deceased. Section 35 was invoked and the interest was treated as benefits under section 36.

Case 2

The deceased was a shareholder of a private company incorporated in Hong Kong. The Hong Kong company was re-structured by the conversion of the deceased's shares to deferred and non-voting shares. The company issued new ordinary shares and allotted these to an offshore controlled company. Section 35 was invoked as the estate accepted that the re-structuring of the Hong Kong company was for the avoidance of estate duty. The controlled companies provisions were applied to the off-shore company.

Case 3

The deceased was one of the three co-owners of a landed property which was sold to an offshore controlled company more than 3 years prior to his death. The financing of the acquisition of the deceased's landed property involved a circular flow of funds and in reality no actual payment was made to the deceased. After the sale of the property, the deceased continued to enjoy the rental income from the property which was deposited into his bank account. Section 35 was invoked as the transaction involved tax avoidance and the deceased clearly received benefits in the form of rental income belonging to the company.

GRANT OF PRIOR ASSURANCE

32. Paragraph 7 of Schedule 2 to the Ordinance provides that “where at any time a transfer of property has been made by any person to a company to which section 35 applies, the company may apply to the Commissioner for an assurance that the provisions of that section will not be applied on the death of such person by reason only of such transfer”. The Commissioner may then issue such an assurance where he is satisfied that the transfer was carried out for bona fide commercial reasons and not for the purpose of avoiding estate duty.

33. It should be noted that an assurance of the kind referred to in paragraph 32 above may only be applied *after* a transfer of property has been made to a controlled company. An application made prior to a proposed transfer will not be entertained.

34. An application for a grant of prior assurance has to be accompanied by a statement of the full facts and circumstances leading to the transfer and supported by relevant documents.

REPORTING OBLIGATIONS

35. Under section 42(1) of the Ordinance, an officer of a controlled company within the meaning of section 34(1), as well as the company itself, are obliged to report to the Commissioner the following -

- (a) the death of the deceased;
- (b) the fact that the deceased made a transfer of property to the company; and
- (c) the fact that benefits accrued to the deceased from the company.

36. The word “officer”, in relation to a company, is defined in section 3(1) to mean a director, manager, secretary or liquidator of the company.

37. The time for reporting is within one month of the death of the deceased. In default of the reporting obligations, each defaulter shall be liable to a penalty at level 6 and to a further penalty equal to three times the amount of the estate duty payable on the whole estate of the deceased [section 42(2)].

Practical Considerations

38. Given the fairly wide scope of the reporting obligations under section 42(1), the Commissioner appreciates that a strict application of the statutory provisions would create practical difficulties. In this respect, the Department takes a pragmatic approach and will only seek compliance from the companies/officers when there are merits for an in-depth probe into the transfers of property made by the deceased prior to his death. In case compliance is sought, the Department will issue a written request to the companies/officers concerned. The time for compliance is usually stated as 1 month failing which the penalties as provided under section 42(2) will apply. It follows that a company/officer not in receipt of such a request is considered to have been relieved from the reporting obligations until such time a request has been made by the Department. It should be noted that such a request may be made at any time after the deceased’s death depending on the circumstances and the need of each particular case.

COLLECTION AND INCIDENCE OF DUTY

39. Section 43(1) provides that the following persons shall be accountable for the duty payable on the death of the deceased by virtue of section 35 -

- (a) the company;
- (b) any person, other than a bona fide purchaser for full consideration in money or money's worth paid to the company, who receives or disposes of assets of the company after the deceased's death, or
- (c) any person, other than the deceased, who received any distributed assets of the company.

40. In practice, the Department first looks to the company itself for the payment of duty exigible under section 35. Where the company is incorporated outside Hong Kong, every person who was a member of the company at the death of the deceased is accountable for a rateable part of the duty in proportion to the value of his interest in that company [section 43(3)].

41. The persons who are accountable for the duty by virtue of section 43(1) are not accountable for any duty that exceeds the value of the assets they have received or disposed of [proviso (i) to section 43(1)]. Furthermore, those who received distributed assets of the company are only accountable for the proportion of the duty payable on the assets they received [proviso (ii) to section 43(1)].

42. The duty payable by virtue of section 35 shall be a first charge by way of floating security on the assets which the company possessed at the date of death of the deceased or at any time thereafter. In addition, there is also a first charge on the distributed assets [section 43(6)]. Such charges do not apply to a bona fide purchaser for valuable consideration without notice [section 43(6) proviso]. Furthermore, in the event of the winding up of the company, the estate duty payable will rank as a preferential debt [section 43(5)].

VALUATION OF SHARES IN AND DEBENTURES OF CONTROLLED COMPANIES

43. Section 44(1) of the Ordinance provides the basis for the valuation of shares in or debentures of a controlled company over which the deceased had the control at any time during the 3 years ending with his death.

44. In general terms, the shares or debentures in question must be valued by reference to the net value of the assets of the company in lieu of the "open-market

value” approach [as prescribed by section 13(5)(a)⁸]. First, the value of the company’s assets, including goodwill [section 3(1)], shall be estimated in accordance with section 13(5)(a). Secondly, from the aggregate value of the company’s assets are deducted the company’s liabilities other than its liabilities for shares or debentures issued and outstanding at the death of the deceased [section 44(2)(a)]. Thirdly, the net value of the assets so ascertained is deemed to be the aggregate value of all the shares and debentures of the company issued and outstanding at the death of the deceased. Finally, the value of any share or debenture shall be a rateable proportion of the net value of the assets so ascertained by reference to their nominal amount.

DISPOSITIONS IN FAVOUR OF RELATIVES

45. Section 45 is enacted to prevent the use of the doctrine that a company is a legal entity distinct from its members to avoid estate duty. Broadly speaking, the effect of the section is that any gifts made to the deceased’s relatives within 3 years before the deceased’s death by a company over which the deceased had control will be treated as gifts made by the deceased. The property taken will thus be deemed to be property passing on the deceased’s death.

46. In this section, the expression "relative" has the meaning attributed to it in section 7 [section 45(4)]. Thus, it covers -

- (a) wife or husband;
- (b) father and mother;
- (c) child, uncle and aunt;
- (d) any issue of a person falling within either (a), (b) or (c) above and the other party to a marriage with any such person or issue;
- (e) concubine recognized as such by the law appropriate to the marriage; and
- (f) references to "child" and "issue" include references to any illegitimate child and to any adopted child.

- END -

⁸ Section 13(5)(a) provides that the principal value of any property shall be estimated to be the price which, in the opinion of the Commissioner, such property would fetch if sold in the open market at the time of the death of the deceased.