



Submissions by the Law Society's Probate Committee and Revenue Law Committee on the Consultation Document on "Estate Duty Review"

The Law Society's Probate Committee and Revenue Law Committee ("RLC") have both considered the Consultation Document on "Estate Duty Review" issued by the Financial Services and Treasury Bureau in July 2004. As two members of the RLC are also members of the Joint Liaison Committee of Taxation ("JLCT"), these Committees have also the benefits of reading the submissions of the JLCT on the Consultation Document. The following are the combined views of the two Committees on the various issues outlined in paragraph 26 of the Consultation Document:

Whether the current estate duty regime should be retained?

(a) Do you think estate duty should be retained?

There are mixed views on whether estate duty should be retained or abolished.

The majority's view

The majority favours the retention of estate duty for the following reasons:

- estate duty is a source of the Hong Kong Government's revenue
- estate duty is a cost effective means of collecting that revenue
- it is not considered to be an appropriate stage for abolition of the estate duty unless there is some guarantee that the loss in Government Revenue could be recovered elsewhere e.g. through introduction of other taxes such as capital gains tax, gift tax, sales tax, etc.
- most modernized countries are observed to have either imposed the estate duty or the like or other taxes such as the capital gains tax, sales tax or inter vivos gift tax
- estate duty is going to be introduced in the Mainland shortly and it seems odd that Hong Kong should abolish the tax at this stage
- there is no evidence that abolition of estate duty will attract investment and deposits in Hong Kong and encourage more companies to be set up in the place. Various factors will affect a decision on the venue to invest and place assets, e.g. the tax scheme in one's own homeland; the investment environment of the place such as political stability and the business opportunities, etc. Some countries will

grant tax relief for estate duty paid in Hong Kong to ensure there is no double taxation

- On the other hand, the instances of listed companies with share registers outside Hong Kong (e.g. the Hong Kong Lands), which are not subject to estate duty, relocating their bases abroad are illustrations that estate duty is not a determinative factor on the choice of venue for investments and for business activities
- whilst the deceased has enjoyed a lifetime of low taxes, this has enabled him to accumulate some wealth and it is justifiable that estate duty should be payable upon his death
- the estate duty tax rate being at 15% is relatively low and there has not been any hardship cases
- estate duty affords an easy means for the Government to spot check evasion of tax during the lifetime of the deceased

The minority's view

The minority favours abolition of the tax on the following grounds:

- estate duty will discourage local investments and deposits
- more local investments and deposits will ensure the stability of the local currency
- a lot of BVI companies have been set up because of estate duty with much fees being paid for overseas services
- the tax is a burden to the general public
- the loss in Government Revenue from the abolition of the tax could well be compensated through additional investments in Hong Kong
- the Estate Duty Ordinance was introduced a long time ago and should be revised to suit modern circumstances

- (b) If you think that current estate duty regime should be retained, have you any suggestions on how the present regime, including its procedures, charging provisions, exemptions, exemption threshold, rates of duty, and interest and anti-avoidance provisions might be improved?

Subject to what are stated below, the Society generally adopts the views and proposals of JLCT regarding improvements to the procedures, exemptions, rates of duty and anti-avoidance provisions of the estate duty regime.

Regarding JLCT's proposal to widen the "*matrimonial home exemption*" ("MHE") to exempt "*estate passing to a surviving spouse*" from the estate duty, the Society believes that the current MHE is discriminatory against single persons and proposes further widening the exemption by introducing the concept of "*Principal Home Exemption*" for the benefit of everyone. Alternatively, the Singaporean experience of granting exemption to dwelling houses up to a certain value could be considered.

Additionally, the Society would like to see improvements to the following unfair features of the present estate duty system:

- interest on estate duty should be charged not from the date of death but after the first executor's year
- the interest rate should be set at a more reasonable level (e.g. being tied to bank savings rates) and subject to review every financial year.
- the current exemption should be modified so that only those parts of the estate over and above the exemption threshold will be chargeable for estate duty. The estate duty rate system should be modified to a progressive rate system rather than the current "slab rate" system where a single rate is applied to the whole estate in cases where the assessable value of an estate falls within a certain band.

If the estate duty regime is to be retained, the Society would urge that it be thoroughly reviewed, updated and amended. The review should cover at least the following areas which should be the subjects of further separate consultations:

- modernization of language of the EDO;
- current exemptions and what changes are necessary or desirable
- procedural reforms with a view to expediting the clearance of estate duty and removing any hardship that is faced by the personal representatives and the family members of the deceased
- the rates of estate duty including interest that is imposed on late payment of estate duty
- the controlled companies provisions and the application of other anti-avoidance provisions

- (c) What factors do you think contribute to the investment and retention of capital in Hong Kong? To what extent does estate duty feature in this? How might adjusting the estate duty regime make a difference? Please try to quantify the effects of any proposed adjustment to the estate duty regime and explain the basis for your estimate.

The Society shares the views of the JLCT. However, without detailed figures, the Society is not in a position to comment specifically on this issue. Estate duty does not appear to significantly affect investment and retention of capital in Hong Kong. Investors generally look for a stable investment environment, growth and/or competitive return. The current estate duty rates are not perceived to be a sufficiently determinative factor. Moreover, various legal vehicles are readily available for holding and making investments. Compared to capital gains tax, the current estate duty implication seems to be of little significance.

Whether the estate duty regime should be adjusted through provision of exemption by reference to “domicile” or “residency” (proposal (a) in paragraph 11)

- (d) Should exemptions based on “domicile” and “residency” be provided? If so, why, and which basis do you prefer, “domicile” or “residency”? What do you suggest for the definition and test of “domicile” and or “residency”?

"Domicile" and "residency" are more complicated concepts than "location" of assets and are not to be preferred. The many different types of residence in Hong Kong for different purposes add more complications to interpretation and administration. The Society is in general agreement with the views of the JLCT.

- (e) Would the proposal to provide exemption from estate duty by reference to “domicile” or “residency” create problems for the estate duty regime? What practical difficulties might there be and how best can they be overcome?

The Society adopts the views of the JLCT. Location of assets seems to be a more equitable basis since the value of assets generally always mirrors the performance of the economy where the particular assets are located. Exemption by reference to "domicile" or "residency" is inequitable and cannot reasonably be expected per se to attract foreign capital or investment.

- (f) What effects, if any, on the asset management industry and the Hong Kong economy as a whole (e.g. in terms of employment level, value of assets managed and inflow of foreign capital) do you think would be brought about by providing exemption by reference to “domicile” or “residency”? Please try to quantify the benefits and describe the basis of your estimate.

The Society shares the JLCT's views on the effect providing exemption by reference to "domicile" or "residency" has on the asset management industry. It is also observed that most, if not all, tax havens do not attract onshore capital investments or commercial activities. Investments go to places where there are capital appreciation and attractive trading profits. Tax havens only attract nominal corporate domiciles.

- (g) Should exemptions be given to specific assets such as bank deposits, listed securities, and collective investment schemes that are authorised by the Securities and Futures Commission under the Code on Unit Trusts and Mutual Funds? If so, the reasons for this?

The Society adopts the views of the JLCT.

- (h) Would the proposal to exempt specific assets create problems for the estate duty regime? What practical difficulties might there be and how best could they be overcome?

The Society adopts the views of the JLCT.

- (i) What effects, if any, on the asset management industry and the Hong Kong economy as a whole (e.g. in terms of employment level, value of assets managed and inflow of foreign capital) do you think would be brought about by providing exemption by reference to asset type? Please try to quantify the benefits and explain the basis of your estimate

See paragraph (f) above.

Whether estate duty should be abolished (proposal (c) in paragraph 11)?

- (j) Do you think estate duty should be abolished? If so, the reasons for this?

As stated in (a), there are mixed views on whether estate duty should be abolished. At the end of the day, this is a policy decision for the Government to consider.

- (k) How would the abolition of estate duty affect different industries (e.g. private wealth management, estate duty planning, the legal, accountancy and surveying professions, investment banks and trustee companies)?

The Society adopts the views of the JLCT.

- (l) What effects, if any, on the asset management industry and the Hong Kong economy as a whole (e.g. in terms of employment level, value of assets managed, repatriation of capital from Hong Kong people and inflow of foreign capital) do you think would be brought about by abolishing estate duty? Please try to quantify the benefits and explain the basis of your estimate.

The Society agrees to the views of the JLCT.

- (m) How best may we ascertain and measure the costs and benefits of abolishing the tax in terms of the net employment gains/losses, potential for increased investments and boost to the asset management industry?

There is a lack of the relevant data available for the Society to make a stance.

Other measures?

- (n) Do you think Hong Kong needs to adopt any other measures or changes together with or instead of adjustments to estate duty in order to develop its role as the premier asset management centre for Asia?

This is more a question for economists than lawyers.

**The Probate Committee & Revenue Law Committee
The Law Society of Hong Kong
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