LC Paper No. CB(2)1817/04-05(02)

Bills Committee on Revenue (Abolition of Estate Duty) Bill 2005

Administration's response to submission of the Society of Trust and Estate Practitioners (STEP)

	Summary of views	Administration's Response
1.	Do not support abolition of estate duty. The case for abolition is not made out. There is no evidence whatsoever that abolition of estate duty will affect foreign investment in Hong Kong or contribute significantly to Hong Kong's claim as the region's premier financial centre. Estate duty in Hong Kong is clearly not a disincentive to acquire wealth.	It is difficult for us to give an accurate estimate of the amount of foreign and domestic investment that will be induced if estate duty is abolished, as investment decisions are influenced by many factors. Nonetheless, we believe that, with abolition of the tax, Hong Kong will become more attractive to investors. While it is possible for overseas investors to exempt themselves from estate duty liability by keeping their investments in Hong Kong below the asset threshold, we have been told by some investment advisers that in order to avoid any uncertainty in the tax liability, it is easier for them to simply advise their overseas clients to invest elsewhere, rather than trying to make efforts to keep the investments under the threshold. HNWIs (particularly in Asia) may well use more than one private bank to manage their wealth. Therefore, as no one single adviser has an overall picture of their various investments, it is virtually impossible to ensure the threshold for Estate Duty is not exceeded. Abolition of estate duty would eliminate any such uncertainty and make Hong Kong more attractive to overseas investors. It is a strategically important move to abolish the tax so as to capture the growing capital market in Asia.

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2.	The revenue lost would have to be found elsewhere.	We expect that there would be increased investments in both the financial and property markets which would generate substantial additional revenue for the Government by way of stamp duties and increased profits tax as a result of greater profits made by companies. In addition, a more vibrant financial market would create more jobs not only in the financial sector but also in the downstream supporting industries such as accounting, trust and legal services. The improved employment would in turn have a positive impact on consumption and the economy more generally which would eventually be translated into greater tax revenue for the Government. In view of the competition both regional and worldwide for development of the financial market, we need to move proactively. Abolition of estate duty is a strategic investment which we believe would be beneficial to the economy as a whole.
3.	Requiring people to contribute a relatively small percentage of their wealth is a comparatively equitable means of raising revenue.	Although the tax is targeted at the better-off, in practice the very well-off may avoid it through various legal means. In other places, estate duty avoidance is also very common. There is unfairness in the tax, as most paying the tax do not belong to the wealthiest class of the community.
4.	The unfairness about estate duty, to the extent that it exists, results mainly from poor enforcement of existing laws and not the nature of the tax itself.	Estate duty is commonly known as a voluntary tax. Plugging the loopholes is not an easy task. Given our territorial basis of taxation, we could not bring back to charge funds transferred out of our

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	Larger estates should bear a greater portion of total duty and our submissions for adjustments of rates and bands and stronger enforcement will achieve this.	jurisdiction. Strengthening the anti-avoidance provisions may not offer a panacea. In fact, the issue of avoidance is also commonplace in other jurisdictions which still have estate duty. It will also undermine one of Hong Kong's fundamental attractions – a simple tax regime that is easy to administer. Strengthening of anti-avoidance measures would not achieve our objective of attracting investments to Hong Kong and help enhance Hong Kong's status as an asset management centre. On the contrary, tightening the measures might discourage investments.
5.	The concern that estate duty provides disincentives to foreign investment in Hong Kong can be addressed by the provision of particular exemptions rather than abolishing the tax altogether.	Exemption of specified types of assets will discriminate against other assets and erode the source-based system of taxation.
6.	Estate tax helps support the non-profit sector by providing incentives to the wealthy to give to charities.	There can be different views as to the way abolition of estate duty would impact on charitable donations. While one may argue that people would donate less if the estate tax were repealed, given the absence of tax benefits, it is also true that if families and individuals are not forced to pay estate taxes, they will have more to give to charity.
7.	There is little evidence that estate duty causes	We are aware of certain hardship cases. Hardship may be caused

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	hardship on relatives of deceased persons.	when their assets were frozen for assessment and in certain cases, the prices of their assets have gone down during the period when their assets are frozen. From the statistics, it is also noted that within 2003/04, 41% of all dutiable cases took more than two years to complete assessment.
8.	Estate duty returns provide the IRD with an excellent source of information to uncover profits tax evasion.	While disclosure in an estate duty affidavit of substantial assets inconsistent with tax returns of the deceased person during his/her life may sometimes provide hints for an investigation into possible liability to taxes under the Inland Revenue Ordinance (IRO), the existence of such assets is not a direct proof of understatement in the tax returns. In recent years, IRD has introduced some new methods to identify potential cases of tax evasion for early investigation. IRD's reliance on estate duty affidavits as a source of information to identify tax evasion cases has considerably reduced over the years and the estate duty affidavit only constitutes a minor and indirect source of information. Besides, after the abolition of estate duty, IRD will continue to receive relevant information from the Immigration Department and the Probate Registry, which would help IRD review the relevant tax files of the deceased person.

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9.	Estate duty is an efficient tax to collect	We accept this. However, the cost of collecting estate duty has increased over the past couple of years, rising from 0.96% in 2001/2002 to 1.26% in 2003/04 and 1.24% in 2004/05. The costs of collecting estate duty in the recent two years are higher than the average cost of collecting other taxes which was 1.14% in 2003/04 and 0.86% in 2004/05. One of the reasons is that the assessment and collection of estate duty is generally more technical and labour-intensive. It is difficult to bring the cost of collection down by business re-engineering process and IT applications. Another reason is that the collection has been rather stagnant despite the general growth in wealth. This may be due to the higher awareness and incidence of avoiding the tax particularly after the judicial decisions on recent cases.
10.	Abolition would remove directly jobs that provide specialist estate duty advice work, and, to some extent, jobs in the trustees services sector.	According to the Hong Kong Investment Fund Association (HKIFA), the abolition of estate duty would encourage more investment funds to domicile in Hong Kong, hence help promote the trust business and paying agent business in Hong Kong. According to HKIFA's views, currently there is always a risk that the investment in a fund will be subject to estate duty. There has therefore been a tendency not to use trusts formed in Hong Kong as investment fund vehicles, and not to use Hong Kong trustees and paying agents, because this could raise a HK estate duty issue for

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		investors. We believe that abolition of the tax will be beneficial to the economy as a whole.
11.	We do not consider abolition would affect the business of investment banks. Abolition is unlikely to benefit the asset management industry in any perceptible way but would negatively impact on the trustee services industry and the legal and accounting profession that support it.	It costs time and money to set up and maintain a plan to avoid estate duty. The avoidance schemes often involve significant costs and normally require the asset holders to give up direct control of the assets. Moreover, there are risks as such schemes might not always work. To avoid the possibility of being caught under estate duty, some people may simply choose to put their money elsewhere. The abolition of estate duty will reduce the costs and thus increase the return on investments, hence increasing the attraction of Hong Kong as a place of investments. Without estate duty, investors would be free to acquire immovable property in their own name or through a local company which they own and control. Similarly, they could have share portfolios in their own names, managed by local fund managers with expertise in the local market. This would increase the demand of middle level asset management and professional services, create employment opportunities and expertise of the industry and in turn make Hong Kong more competitive as an international financial centre.

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		Abolition of estate duty would eliminate any uncertainty and make Hong Kong more attractive to overseas investors. The abolition would also avoid any need for estate duty planning schemes which could be costly and cumbersome. According to SFC's informal consultation with some major banks which offer financial planning services and major independent financial planning firms, they would advise clients to invest more in Hong Kong, such as in Hong Kong authorised funds. They would no longer need to recommend clients to place more assets offshore.
12.	We do not believe that the essential basis for imposition of estate tax in Hong Kong should be changed from the current territorial basis. Providing exemption by reference to domicile or residency would have an imperceptible impact on the asset management industry and the Hong Kong economy as a whole.	Agreed. To exempt "non-domiciles" or "non-residents" from estate duty would be inequitable to local residents and may discourage people from moving to Hong Kong and bringing with them valuable human and monetary capital. It is a very difficult concept to apply in Hong Kong's context. In addition, the application of "domicile/residency" rules to the taxation of property passing on death is far more complex than its application to the taxation of employment income.
13.	We advocate the exemption of bank deposits from estate duty because it is now very simple to avoid Hong Kong estate duty on Hong Kong bank deposits of either local or foreign currencies by establishing those accounts with the non-Hong Kong branches of	Granting exemption to specific assets would discriminate against other assets. Also, such an exemption would not be able to encourage investment in other forms and its effects in helping to develop Hong Kong into an asset management centre. Besides, the proposal would not be able to achieve our objective to relieve possible hardship for

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	Hong Kong or foreign banks. It would be impossible to tighten up estate duty law or enforcement procedures to stop people avoiding Hong Kong estate tax on bank deposits by moving them out of Hong Kong. We do not advocate the exemption of Hong Kong public company incorporated or listed securities from estate duty. There is no evidence that foreign individuals pay significant amounts of Hong Kong estate tax on public listed shares on their death. Estate taxes do not discourage foreign investors in stock markets because few foreign investors in fact pay estate taxes on stock market investments. Nor are we aware of any evidence that suggests jurisdictions like Australia have experienced consequential increased investment in their stock markets.	SMEs.
14.	There is no need to exempt unit and mutual funds since these vehicles are rarely Hong Kong incorporated or constituted and are therefore outside the HK estate duty net in any event.	Noted.
15.	Consideration be given to increasing the thresholds	Increasing the exemption threshold may help to allow some people

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	so that there is no duty on the principal value of an estate up to, say, the first HKD7.8 million, that the rate on the value of estates between, say, HKD7.8 million and HKD15 million should, say, be 10% and that the rate on the value of an estate in excess of, say, HKD20 million should, say be, 20%. Suggest moving to a marginal rate system.	with fewer assets to leave the tax net. However, such families would still need to comply with the estate duty procedures at a time when they are still grieving from the loss of a family member before they can gain access to the estate of the deceased. There could still be hardship for the SMEs due to freezing of assets, even if there might not be any estate duty liability at the end. Besides, the increase in threshold would not be able to change the unfairness in the tax that the wealthiest class of people could make arrangements to avoid it. More importantly, the proposal would not achieve our objective of attracting investments to Hong Kong and help enhancing Hong Kong's status as an asset management centre.
16.	The controlled company provisions should be simplified and then properly enforced. Suggest either to narrow the ambit of the provisions in the area of what "benefit" ought to be included to determine both liability and the formula to determine quantum. The nexus for liability should be limited to transferors of property who receive actual benefits. Alternatively, suggest repealing the controlled company provisions in favour of provisions that would deem shares of non-Hong	The DIPN issued on 21 December 2000 has granted a few concessions including limiting the liability to transferors of property. The controlled company provisions have been rarely applied because of the common use of offshore discretionary and unit trusts to hold local assets to avoid the duty, to which the provisions do not apply. The proposed legislative amendment would complicate the law and constitute a departure from the principles of neutrality and territoriality currently followed in Hong Kong, not least its deterrent effect on inflow of investment.

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	Kong companies whose Hong Kong assets constitute more than 50% of the total value of the company's assets to be Hong Kong situated assets.	
17.	The existence of high estate taxes in US and UK does not appear to have a detrimental effect on these markets.	While some jurisdictions still levy estate duty, a number of economies in the region, including India, Malaysia, New Zealand, Australia and Macau, have abolished estate duty over the past 20 years. In Europe, Italy and Sweden have also abolished the tax. The US House of Representatives has also recently passed a Bill to permanently repeal estate duty and the Bill has now been submitted to the Senate for consideration. We should also note that London and New York are both well established international financial centres with established very large domestic economies or an established natural base. Centres in smaller economies like Ireland or Luxembourg are positioned within the legal framework of European Union and enjoy unimpeded access to its vast markets. In our case, the financial markets in the Asia Pacific region have quickened the pace of their development in recent years. Hong Kong is facing increasing competition particularly from other economies in the region in the financial sector. We need to increase our competitive edge vis-à-vis our competitors.

Financial Services and the Treasury Bureau
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