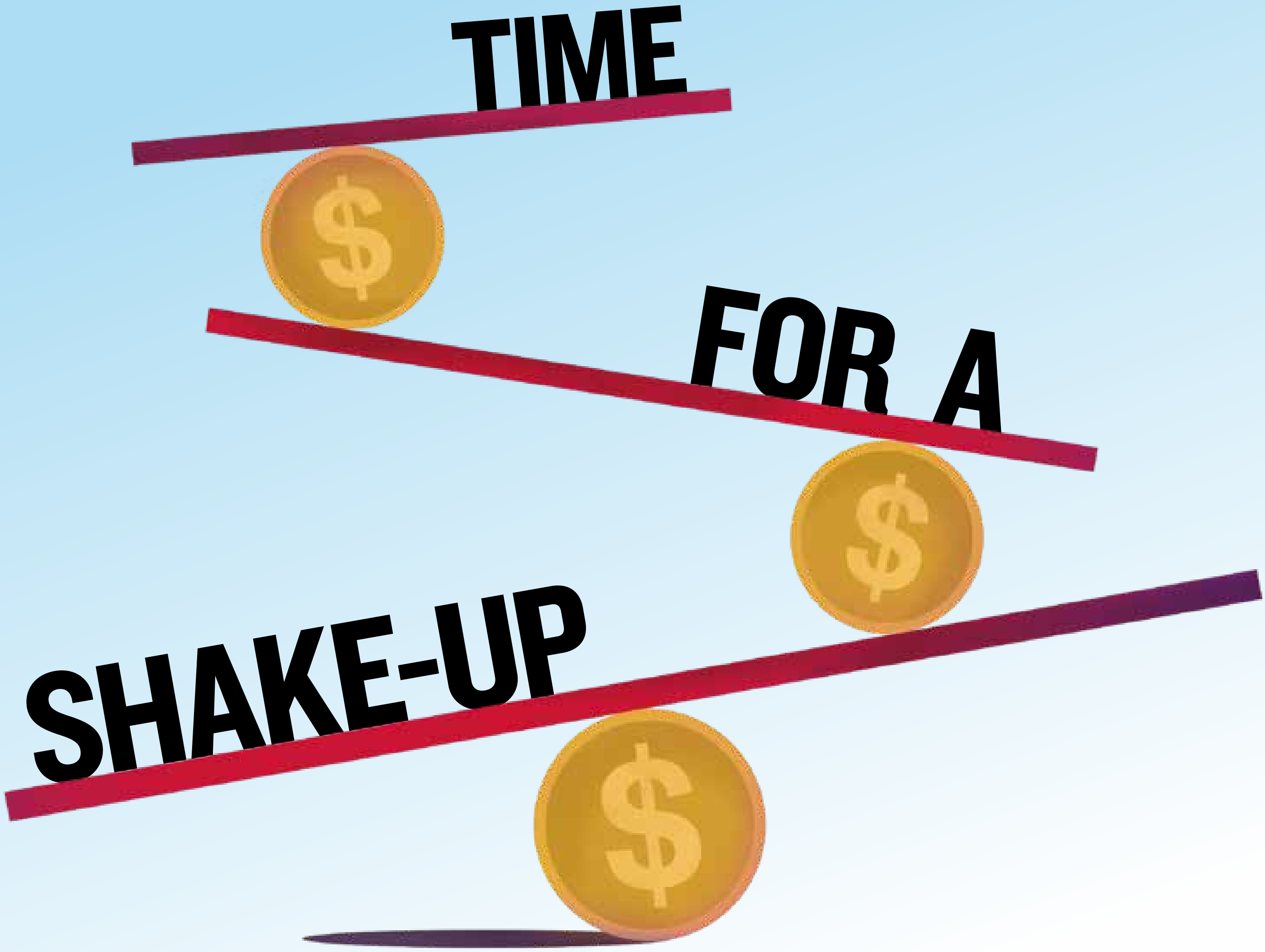
TIME FOR A SHAKE-UP



Philip Marcovici illustrates how reintroducing estate and donation duties in Hong Kong could prove constructive and reduce inequality

> **KEY POINTS**
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> **WHAT IS THE ISSUE?**
> This article suggests a proactive approach towards addressing inequality. It is the author's view that inaction destabilises our societies and is not in the interests of the families we serve.
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> **WHAT DOES IT MEAN FOR ME?**
> Debate is encouraged on what it takes to achieve fairness in tax systems, recognising that this is in the interests of all.
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> **WHAT CAN I TAKE AWAY?**
> Hong Kong estate and donation duties are an example of how the Common Reporting Standard and transparency generally assists tax authorities in imposing new taxes. STEP members, with their considerable knowledge base, should be among those recommending the right changes.

Estate duty in Hong Kong was abolished in 2006. It is now time for its return, together with a comprehensive donation tax.

In 2015, Christine Lagarde of the International Monetary Fund emphasised that growing inequality is not only a matter of headlines, but a problem for economic development. Reducing inequality is therefore not only morally and politically correct, but good economics, essential to more inclusive, sustainable growth.

Inequality is just not right. Estate and donation duties (EDD) would not eliminate inequality in Hong Kong, but would be a step in the right direction.

GOVERNMENT POLICIES

Taxation alone does not address inequality. The Hong Kong government needs to tackle the issue in a real way through a focus on education, healthcare, the environment and housing. While there are economic arguments against hypothecating taxes, this should be considered when specifically addressing growing inequality.

WHY EDD?

Top Hong Kong tax rates are well below 20 per cent for even the highest earners and apply only to Hong Kong source income. Neither capital gains nor dividends are taxed, and indirect taxation, such as a value-added tax, does not exist.

Governments need a broad revenue base, and Hong Kong is no exception, despite historic success in generating revenue through land sales and enjoying significant budget surpluses. Hong Kong cannot rely on a narrow base of taxation for the long term.

As well as broadening the tax base, EDD would introduce to Hong Kong a sense that government cares about those in need. Historically, estate duty contributed around HKD1 billion annually, a relatively insignificant amount given current budget surpluses. The reality is that concentration on land sales and property stamp duties is unsustainable, and, in light of this, broadening the revenue base is of vital importance. Indirect taxation may be part of the future of Hong Kong's tax system, but it is regressive. An EDD system would help balance indirect taxation, and allow for lower rates and exemptions for necessities.

LOGISTICS

Fair taxation needs to be simple and transparent. While there will be challenges in adopting the right EDD system in Hong Kong, there are many examples of regimes that have made it work. Hong Kong's own experience with estate duty and the many solid recommendations that have been made regarding its retention and reform[1] will help in this regard.

IMPOSING EDD WHILE MAINTAINING ALLURE

Some of the arguments for abolishing estate duties reflect a view that having estate duties could be harmful to Hong Kong's status as a wealth management centre. Singapore, having also abolished estate duties in 2008, is now reconsidering the matter, and the debate there regarding steps to create a fairer society is in progress.

There are few reasons to believe that an EDD system would chill the development of Hong Kong as a wealth management centre or reduce its allure as an investment destination. Other successful wealth management locations – the US, the UK and Switzerland being but three examples – have demonstrated that more important factors are key. Exemptions apply to encourage certain activity, and guidance from the experiences of other jurisdictions would be instructive for Hong Kong. An effective EDD regime should not be viewed as a deterrent to investment. Indeed, there are many global investment centres that continue to attract significant foreign investment, despite such taxes. Some exemptions are carefully targeted to apply; in some cases, the tax exposures are part of what investors anticipate in relation to their investment.

Hong Kong has options as to how its EDD system is formulated to minimise the negative impact on choices investors make.

CRS AND EDD

The changing world has resulted in the adoption by Hong Kong and most other jurisdictions of new automatic information exchange using the Common Reporting Standard. Hong Kong both automatically sends information to other countries regarding bank accounts in Hong Kong and receives such information from other countries in relation to its residents.

But even more is happening in the world of tax transparency. Registers of ownership of companies and other investment vehicles, transparency on the ownership of real estate and other assets, and a growing range of tools based on technology are leading to a world where tax authorities will have the information needed to enforce their tax systems.

For Hong Kong, developing an EDD system is now a much easier task than in the past.

WHY NOT HOME EDD OBLIGATIONS?

Wealth owners in Hong Kong investing globally are taxed in other countries, subject to tax treaties Hong Kong is a party to.

If Hong Kong had an EDD system, it could develop a network of estate and gift tax treaties similar to those held by other jurisdictions, protecting its revenue base and helping to manage residents' tax exposure abroad, adding to the many attractions of being connected to Hong Kong.

Why should a Hong Kong investor pay inheritance taxes of up to 40 per cent of the value of real estate in the UK, but no tax on real estate in Hong Kong? And in the case of the UK, the tax cannot be avoided by interposing a non-UK company.

THE BASIC LAW

The Basic Law[2] is likely to feature in debates regarding the development of an EDD regime.

As it pertains to tax, the Basic Law should be viewed as providing broad economic guidelines. Unlike substantive rights, such as the right of abode, economic articles should not be regarded as immutable. Hong Kong should be freely able to decide on the imposition of an EDD, reflecting changing economic needs. The contrary view that the Basic Law entrenches an approach to taxation would be based on, for instance, art.108, which prescribes that Hong Kong practise a low-tax policy. It is highly debatable whether such a policy should be viewed as mandatory, precluding residence-based taxation and particularly a low-rate EDD designed to permit Hong Kong to continue to offer 'low rates of taxation' while building a fairer society.

A FAIR APPROACH?

Surely, it would be fair if:

- those ordinarily resident in Hong Kong were subject to EDD with a top rate of 8 per cent on the value of assets passing to anyone other than a spouse or life partner, on death or by way of donation;
- a resident's principal home, if lived in full time, and the first HKD10 million of other assets, were exempt from EDD;
- EDD started at 3 per cent for donations and estates over HKD10 million, rose to 5 per cent at HKD20 million and applied at the full rate of 8 per cent for estates over HKD30 million;
- EDD applied to all worldwide assets, with credits for taxes actually paid abroad;
- those not ordinarily resident in Hong Kong were subject to EDD only on their Hong Kong-*situs* assets, with perhaps only bank deposits being exempt;
- collections from EDD were hypothecated and used to only support programmes designed to address inequality: education, healthcare, housing and the environment;
- no deductions were to apply – even for other charitable donations or otherwise – keeping things simple and free from abuse. With a low top rate of 8 per cent, there would be little discouragement of additional contributions, whether to charity or as voluntary additional payments to government programmes linked to the EDD.

It is time for serious reconsideration of Hong Kong tax policy in relation to EDD, and for a meaningful move towards creating a more fair society.[3]

1 Among these is an excellent article by Andrew Halkyard, then with the Faculty of Law at the University of Hong Kong: 'Hong Kong Estate Duty: A blueprint for reform', *Hong Kong Law Journal*, 30:47 (2000). **2** *The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China* **3** The author of this article is happy to provide more detailed ideas on how a fair system of EDD can work. **4** While the views expressed are only those of the author, he would like to thank Andrew Halkyard and Michael Olesnicky for their valuable input.

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