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What an inheritance tax would mean for Malaysians

- **An** inheritance tax will discourage entrepreneurs from working harder to accumulate wealth
- **The** abolition of inheritance and estate taxes will increase capital assets & boost GDP

Bearing in mind the soft economic conditions, it is not a good idea for inheritance tax to be introduced at this time, says Liew

by **Raymond Liew**

Over the years, it has been rumoured that inheritance tax will be introduced in Malaysia but to date it has been put on hold.

That begs the question: "What is inheritance tax?"

Inheritance tax is applied on the estate – property, money and possessions – of someone who has passed away.

It is also often referred to as inheritance and estate taxes, which in essence are referred to as "death" taxes.

It can have a significant financial impact on one's assets if one is not ready for their imposition.

Inheritance and estate taxes are imposed differently depending on the country.

An estate tax is calculated on the net value of the deceased's overall property while an inheritance tax is calculated on the inheritance received by individuals.

In essence, beneficiaries i.e. individuals who inherit the estate, do not normally pay tax on "things" they inherit.

However, there may be taxes to pay such as rental income.

Generally, money from the estate is used to pay inheritance tax, which in this case is by the "executor" if there is a will.

Inheritance and estate taxes are in essence a wealth distribution tax.

This means that the taxes affect the rich to give to the poor, creating what is hoped to provide equal opportunity for everyone.

Inheritance tax in Malaysia was abolished back in 1991.

The prime reason was due to poor tax collection, as the tax was only applicable to a specific threshold and was only applicable when a person died.

During that time, net worth assets exceeding RM2 mil were taxed at 5%, and 10% on net worth assets exceeding RM4 mil!

The tax was done away with because it was inefficient and narrow-based where tax revenue collection declines over time.

An effect of these taxes is that wealth is then channelled away from the country where inheritance tax is not applicable.

Domestic capital assets

With a declining tax rate, an eroding tax base and high compliance costs leading to inefficiency for the tax collection along with high administrative costs.

This tax collection exercise wastes time which will be better spent on improving the value of the capital assets of an individual.

One needs to bear in mind that inheritance & estate taxes are exclusively taxed on domestic capital assets, which are assets that help to make the country more prosperous and productive.

I am of the strong view that these taxes are a result of poor economic policies, which will see the outflow of capital assets from the country, resulting in restriction in jobs growth.

The introduction of an inheritance tax will discourage entrepreneurs from working harder to accumulate wealth and drive them away from the country.

One would argue that an inheritance tax is only introduced where there is inequality in the distribution of income or capital asset accumulation and is applicable in a developed country.

Another reason is when the overall tax collection in a country is low or when there are no other taxes other than income tax.

Not a good idea

In Malaysia, we pay taxes practically for everything we use or consume, such as income tax at source from our earned income to arrive at "net disposal income," road tax for motor vehicles, excise duty, stamp duty for transfer of assets, tax on licences to include 6% GST which was introduced on April 1, 2015 but was zero-rated from June 1, 2018.

McMillan Woods Tax Services chairman Kolonel (K) Tan Sri Mohd Shukor Mahfar feels that "Malaysia is still dependent on foreign investments to drive the domestic trade and is still a capital importer.

"Bearing in mind the soft economic conditions, it is definitely not a good idea for inheritance tax to be introduced at this point in time."

Top Estate or Inheritance Tax Rates to Lineal Heirs in the OECD

RANKING	COUNTRY	TAX RATE
1	Japan	55%
2	South Korea	50%
3	France	45%
4	United Kingdom	40%
4	United States	40%
6	Spain	34%
7	Ireland	33%
8	Belgium	30%
8	Germany	30%
10	Chile	25%
11	Greece	20%
11	Netherlands	20%
13	Finland	19%
14	Denmark	15%
15	Iceland	10%
16	Turkey	10%
17	Poland	7%
17	Switzerland [1]	7%
19	Italy	4%
20	Luxembourg [2]	0%
20	Serbia	0%
20	Slovenia	0%
20	Australia	0%
20	Austria	0%
20	Canada	0%
20	Estonia	0%
20	Israel	0%
20	Mexico	0%
20	New Zealand	0%
20	Norway	0%
20	Portugal	0%
20	Slovak Republic	0%
20	Sweden	0%
20	Hungary [3]	0%
	OECD Simple Average	**15%**

[1] Tax is levied at canton level, not federal level.
[2] Luxembourg has an estate tax but lineal heirs are exempt.
[3] Hungary levies an inheritance tax but close relatives including lineal heirs are exempt.

The highest top estate tax rate to lineal heirs can be found in Japan at 55%. South Korea (50%) and France (45%) also have rates higher than the US. At the low end, 15 of the 34 countries in the OECD have no taxes on property passed to lineal heirs. The average estate tax rate across the OECD is 15% with a median tax rate of seven percent.

SOURCE: FAMILY BUSINESS COALITION

Should the inheritance tax be introduced, I would have thought that a reasonable flat rate of 5% should be applicable for overall asset value of say, RM100 mil.

But that is wishful thinking!

The best is a flat rate across the board with overall asset value exceeding a set limit, which is also international best practice.

If there is a will, executors will face difficulty in determining the value of the assets.

The calculation of this asset value may be subjective and can be challenged by tax authorities.

The cost of valuation of immovable properties is also high, with different timings of dates i.e. date of death and date of distribution.

Asset transfers may take place immediately prior to the introduction of inheritance tax unless it is implemented immediately without notice.

To date, over 15 of the 34 Organisation for Economic Cooperation and Development (OECD) countries do not impose inheritance tax on property passed on to the next generation.

In Singapore, prior to 2008, the government levied estate duty, which was removed in order to encourage more local and overseas investors to keep their capital assets in the country.

Citizenship

Indonesia does not levy inheritance tax or gift tax as long as there is no business or employment relationship.

However, if real estate is transferred after death, a real estate transfer tax can be levied.

There is no inheritance or estate tax in Cambodia.

Legally speaking, foreigners are not allowed to inherit property in Cambodia and must first apply for citizenship to qualify.

Similarly, there is no such tax in Laos but in Myanmar, inheritances and gifts are subject to stamp duty.

The Philippines has an estate tax in place where non-residents or foreigners are only liable for it for property located in the Philippines.

In 2014, inheritance tax was introduced in Thailand, where 10% is levied for assets valued in excess of US$1.5 mil (RM5.99 mil).

In Brunei, estate duty is applicable to all immovable property located in Brunei and also movable property outside Brunei, exceeding an accumulated value of B$2 mil (RM5.59 mil).

The inheritance tax rate is currently set at 3%.

In Vietnam, any inherited property exceeding VND 10 million RM1.752 mil) is taxed at the flat rate of 10%.

Certain exemptions are available involving spouses, relatives and children.

The double taxation treaty is applicable when there is a reciprocal arrangement.

Where the deceased lived via this agreement, the executor can reclaim the inheritance tax on the same assets.

The UK's inheritance tax rate is on par with the US at 40%. That is the fourth highest in the world next to Japan at 55%, South Korea at 50% and France's 45%.

For the UK, inheritance tax is levied on the estate of the deceased with a certain band applicable. Exemptions include a basic threshold which is higher if given away – to spouses (including civil partner), charities or a community amateur sports club.

Taper relief is given where inheritance tax is levied at less than 40%.

The tax also covers gifts if the value exceeds the threshold limit and when a person dies within seven years of the gift being given. Small gifts are exempted.

Seven-year rule

The irony is that there is a restriction on the value of gifts, such as a limit on value for a wedding or civil ceremony or financial assistance to help another person's living costs such as a relative or a child. And the seven-year rule is based on a reducing scale rate. So far as I am aware, inheritance tax is only paid on UK assets.

Other countries that have high tax rates include Spain, Ireland, Belgium, Germany, Chile, Greece, the Netherlands, Finland, Denmark, Iceland and Turkey. They range between 10% and 34%. Poland and Switzerland are at 7% while Italy taxes at 4%.

The US has one of the highest rates but it also has among the most exemptions. As a result, it raises little tax revenue and is only applicable to a few households. Estate tax collection declined over the years from US$38 bil to around US$20 bil in 2015.

The exemption of US$5,430,000 in 2015 is considerably larger than the exemptions in France (US$105,945), Germany (US$423,782) and the UK (US$488,280). The US exemption has grown substantially in the last 15 years. Most countries that levy inheritance and estate taxes do so with lower rates and with various exemptions, aimed at making taxes more progressive. I believe that exemptions will continue to expand, hence leading to lesser tax revenue collection.

As tax revenue falls for such taxes, the fiscal benefits of the tax collection to the government are eventually outweighed by the administrative, political and economic costs of a narrow-based tax regime. Abolition and repeal becomes a better viable option.

Eleven countries have repealed the inheritance and estate taxes since 2000, including Macau and Hong Kong, in line with mainland China. Norway and Sweden are included too.

In my view, the abolition of inheritance and estate taxes will increase capital assets in a country, boost gross domestic product where the increased value of capital assets will help create more jobs. Repealing these taxes may result in higher income tax collection due to an increase in the the country's economic growth. FocusM

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