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**Is estate duty truly resting in peace?**

***Millionaires who die sans estate planning pose a challenge to rationale for its abolition***

**By IVAN PNG**

THE government introduced a Bill in Parliament last week to abolish estate duty with effect from Feb 15, 2008. Estate duty presents a nice counterpoint between two branches of economics - public finance and the nascent discipline of behavioural economics.

Estate duty has a long history in Singapore. It was established by the colonial government in 1929. It is actually an inheritance tax and has been widely regarded by public finance economists as one of the most efficient ways for the government to collect revenue.

The government's leading source of revenue is income tax. The major downside of income tax is that it discourages people from working harder. By contrast, the possible disincentive effect of estate duty is to persuade people to live longer.

Until February, estate duty was levied on all estates in excess of exemptions of \$9 million for residential property and all other assets for \$600,000. Legislators, scholars, and concerned citizens had called for the discrepancy in exemptions between residential property and other assets to be rationalised. Prime Minister Lee Hsien Loong accepted this in principle.

Then, in this year's Budget, Finance Minister Tharman Shanmugaratnam decided to abolish real estate duty entirely. Minister Tharman remarked that estate duty affected 'our middle and upper-middle-income estates disproportionately compared to wealthier ones'.

The Minister's implication was that the very wealthy could use trusts and other legal mechanisms to avoid estate duty. This view was supported by various tax experts.

At this point, it is useful to apply behavioural economics to public finance. Behavioural economics originated with Herbert Simon, economist and psychologist, who famously observed that individuals are subject to bounded rationality. Their decision-making is subject to limited information, cognitive skills, and thinking resources. The lesson from behavioural economics is that individuals are subject to systematic biases in their decision-making.

Revenue statistics show that, contrary to popular belief, not all wealthy people plan their estates perfectly so as to avoid estate duty. In the figure opposite, the vertical bars show estate duty collections in millions of dollars a month.

Over the period 2000-08, the average monthly collection was \$11.4 million. However, there were several quite clear spikes in collections. There are two possible explanations for these spikes.

Either a disproportionate number of people died in those particular months. Or one or several persons with immense wealth died and left estates of high value - many millions of dollars more than \$9 million in residential property and \$600,000 in all other assets.

Let's consider the first possible explanation. In the figure, I also show the number of deaths in thousands on a monthly basis (the blue dots). Unlike estate duty collections, deaths in Singapore have been quite stable at about 1330 per month. In particular, there were no obvious death waves that could possibly account for the spikes in estate duty collections.

So, the only possible explanation of the spikes in estate duty collections is that some rich people had not planned carefully enough to avoid estate duty. Consequently, they (or more precisely, their beneficiaries) had to pay estate duty.

The graph reveals four particular spikes in 2004, including collections of \$108.4 million, \$63.1 million, \$97.9 million, and \$114.4 million in March, June, September, and October 2004 respectively.

Consider the highest spike of \$114.4 million. Suppose that it was due to a single estate. Subtracting the average monthly collection of \$11.4 million, the estate duty payment was \$103 million. On a rough calculation, at a 10 per cent rate of estate duty, the estate must have been worth \$1.03 billion. The second-highest spike of \$108.4 million would have been due to an estate worth only slightly less.

Evidently, two or more multi-millionaires who died around 2004 did not minimise estate duty in the way that tax experts had supposed.

Scanning the obituary pages, it is possible to speculate who might have been responsible for such a large payment of estate duty. Financier and hotelier, Khoo Teck Puat, died in February 2004. He was the richest person in Singapore. Besides controlling major assets in Singapore, he was the largest shareholder in Standard Chartered Bank. The late banker's fortune was reputed to be worth billions of pounds sterling.

The late tycoon was famously secretive. After his death, it became known that he owned substantially more of three listed companies - Goodwood Park Hotel, Hotel Malaysia, and Central Properties - than he had declared. The revelation led an investigation by the Commercial Affairs Department.

It is interesting to contrast the late financier with another banker. Tan Chin Tuan died in November 2005. Nicknamed Mr OCBC, he ran the Oversea-Chinese Banking Corporation for many years. He owned or controlled large blocks of shares in listed companies including OCBC, Great Eastern Life, and Straits Trading.

However, there were no obvious spikes in estate duty collection around the time of

Mr Tan's death. The closest was \$29.7 million in May 2006, which seems trivial relative to the late banker's wealth. So, probably, the famously meticulous Mr Tan had undertaken very careful estate planning.

It would almost seem axiomatic that people would do their best to avoid taxes. Yet, at least two multi-millionaires who died around 2004 did not do so. With their fabulous wealth, they definitely had sufficient resources to engage lawyers, establish trusts, etc. But they did not do so. Only the taxman knows their identities.

The great claim of behavioural economics is to have identified the direction of systematic biases in individual decision-making. Singapore's experience with estate duty poses a rather challenging question for behavioural economics: How to explain why some multi-millionaires planned carefully for their death and why others did not? It also poses a bit of a challenge to Finance Minister Tharman's rationale for abolishing estate duty.

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Estate duty & deaths Chart 2

