

立法會
Legislative Council

LC Paper No. CB(1) 2444/10-11

Ref : CB1/BC/2/10

Bills Committee on Stamp Duty (Amendment) (No. 2) Bill 2010

Purpose

This paper reports on the deliberations of the Bills Committee on Stamp Duty (Amendment) (No. 2) Bill 2010 (the Bills Committee).

Background

2. The increased global liquidity, very low interest rate environment and keen competition in the mortgage market have fuelled the surge in property prices. To curb speculation, the Administration has implemented a number of measures, inter alia, increasing the rate of stamp duty payable in relation to transactions of immovable property valued more than \$20 million from 3.75% to 4.25%, and disallowing deferment of payment of stamp duty chargeable on an agreement for sale made in respect of residential property valued more than \$20 million. While these measures are taking effect, the private residential property market is still volatile owing to extraordinary external factors.

3. According to the Administration, the exuberant state of the property market has spread to the mass market. The recent property boom was fuelled by a heavy element of speculative activities, as suggested by the 32% surge in the number of "resale within 24 months" in the first nine months of 2010, as compared with the same period in 2009. Of these, the number of "resale within 12 months" surged by 114%, indicating a shift in speculative activities to a shorter horizon. There was also a higher incidence of short-term resale in the lower end market, with 84% being transactions below \$3 million in the first half of 2010. Following the announcement of the launching of the second round of "quantitative easing" by the US Federal Reserve in November 2010, more funds are expected to flow to the emerging markets, in particular Hong Kong given its strong economic fundamentals and absence of capital control. These have aggravated the speculative activities in the property market.

4. In view of these developments, the Administration considers it necessary to introduce further measures targeting at speculators, including a special stamp duty (SSD) on the sale of residential properties within 24 months after acquisition, in order to curb speculation, reduce the risk of the development of property bubble and ensure the healthy and stable operation of the property market.

The Bill

5. The Bill seeks to amend the Stamp Duty Ordinance (Cap. 117) (SDO) to –

- (a) impose a SSD chargeable on an agreement for sale or a conveyance on sale of any residential property acquired on or after 20 November 2010 if the property has been acquired by the vendor under the agreement or the transferor under the conveyance for 24 months or less at the following regressive rates –
 - (i) 15% if the property has been held for six months or less;
 - (ii) 10% if the property has been held for more than six months but for 12 months or less; and
 - (iii) 5% if the property has been held for more than 12 months but for 24 months or less; and
- (b) cancel the existing arrangements for deferral of payment of stamp duty chargeable on residential property transactions valued at \$20 million or below.

The Bills Committee

6. At the House Committee meeting held on 10 December 2010, Members agreed to form a Bills Committee to study the Bill. Under the chairmanship of Hon James TO, the Bills Committee has held 13 meetings. The membership list of the Bills Committee is in **Appendix I**. Apart from discussion with the Administration, the Bills Committee has also invited views from interested parties, including the relevant trades and professions. 25 organizations/individuals have made written and/or oral representations to the Bills Committee. A list of these organizations/individuals is in **Appendix II**.

Deliberations of the Bills Committee

7. The Bills Committee generally supports the policy intent of the Bill to curb speculation. In the course of deliberation, members have examined issues relating to the retrospective effect of the Bill, the scope of the Bill, determination of the holding period, liability for SSD, provisions for exemptions, efficacy of SSD in curbing speculation in residential properties, and the need for sunset clause for SSD. The deliberations are summarized in the ensuing paragraphs.

Retrospective effect of the Bill

8. The Bill stipulates that the Stamp Duty (Amendment) (No. 2) Ordinance 2010, if enacted, is deemed to have come into operation on 20 November 2010.

9. The Bills Committee has expressed concern about the retrospective effect of the Bill, and enquired whether other existing revenue ordinances have similar retrospective effect. The Administration has explained that to deter speculation, the Financial Secretary announced on 19 November 2010 the introduction of SSD (on top of the current ad valorem stamp duty) which would come into effect on 20 November 2010, subject to the passage of the Bill. To avoid inadvertent creation of a loophole for speculation during the period prior to the enactment of the legislation, the Bill will take effect retrospectively from 20 November 2010. The Administration has also advised that both the Inland Revenue (Amendment) Ordinance 1987 and the Inland Revenue (Amendment) Ordinance 1992 were passed with retrospective effect. An example is the cessation of tax deduction for expenditure incurred from purchase of trademark, as announced by the then Financial Secretary on 17 April 1991. The measure took effect from 18 April 1991 while the legislation to amend the relevant section 16E of the Ordinance was enacted on 13 March 1992. There are also examples of existing ordinances, other than revenue ordinances, which were passed with retrospective effect. These include the Societies (Amendment) (No. 3) Ordinance 1988 and the Bankruptcy (Amendment) Ordinance 2005.

10. Some members have enquired about the consequences if the commencement date is repealed or amended. According to the Administration, the public is well aware of the effective date of SSD as announced, and buyers/sellers have already taken into account SSD when considering flat sale/purchase or otherwise on or after 20 November 2010. Repealing or amending the commencement date will only cause confusion and undermine the clear message of the Administration's determination to curb speculation.

Scope of the Bill

11. The object of the Bill is to amend SDO to impose a SSD chargeable on an agreement for sale or a conveyance on sale of any residential property, if the property has been acquired by the vendor under the agreement or the transferor under the conveyance for 24 months or less.

12. The Bills Committee has enquired about the definition of "residential property", and whether the definition covers properties that could be used for both residential and commercial purposes. The Administration has advised that "residential property" is defined under section 29A(1) of SDO as "any immovable property other than "non-residential property"". "Non-residential property" is defined as immovable property which, under the existing conditions of –

- (a) a Government lease or an agreement for a Government lease;
- (b) a deed of mutual covenant within the meaning of section 2 of the Building Management Ordinance (Cap. 344);
- (c) an occupation permit (OP) issued under section 21 of the Buildings Ordinance (Cap. 123); or
- (d) any other instrument which the Collector is satisfied effectively restricts the permitted user of the property,

may not be used, at any time during the term of the Government lease in respect of the property or during the term of the Government lease that has been agreed for in respect of the property (as is appropriate), wholly or partly for residential purposes. These definitions were adopted in 1992 when the Administration amended SDO to require the payment of ad valorem stamp duty within 30 days after the entering into an agreement for sale of a residential property, rather than after the execution of the Assignment, as one of the measures to curb speculation of residential properties. The classification of premises in terms of "residential property" and "non-residential property" is by reference to their permitted use rather than actual use, since "permitted use" forms an objective basis for the Inland Revenue Department (IRD) and the market to know with certainty whether a property is "residential" or otherwise. In practice, the description of a property in an OP will be recognized as the only permitted use of the property at the time of issue of OP unless specified otherwise in any subsequent relevant instrument. When the "actual use" of a site does not fully comply with its "permitted use", the relevant government departments can take enforcement action to restore the site back to its "permitted use".

13. Some members have opined that the scope of the Bill should be extended to cover non-residential properties to deter the spread of speculative activities to non-residential property market, given that the rise in non-residential property prices might drive up commercial rents which would in turn affect the livelihood of the general public. According to the Administration, the latest measures of the Hong Kong Monetary Authority (HKMA) announced on 19 November 2010 on tightening the loan-to-value (LTV) ratio of mortgage lending also cover commercial/industrial premises or retail premises. Specifically, the maximum LTV ratio for all non-owner-occupied residential properties, properties held by a company and industrial/commercial properties has been lowered to 50% regardless of property values. While SSD is targeted at residential properties, the Administration will continue to closely monitor the market and take further measures as necessary.

14. The Bills Committee has also enquired about the basis upon which the threshold of 24 months is arrived at, and the reason for applying SSD at regressive rates for different holding periods. According to the Administration, the shorter the holding period before resale, the more likely the transaction is for speculative purpose. Statistics have revealed that there is a surge of 32% in the number of resale within 24 months in the first nine months of 2010 compared with the same period in 2009. Of these, the number of resale within 12 months has surged by 114%, indicating a shift in speculative activities to a shorter horizon. To deter speculative activities, there is a need to impose SSD to increase the cost of short-term transactions. The Administration regards a 24-month duration where SSD is applicable as appropriate and should not affect genuine home buyers and long-term investors who are unlikely to sell their flats over a 24-month period of time. To forestall the spread of speculative activities to a horizon beyond 12 months, SSD at a lower rate is imposed on resale after the property is "acquired" for more than 12 months but for 24 months or less.

Determination of the holding period

15. For the purpose of determining the holding period so as to ascertain the liability of SSD, the Bill provides that a person "acquires" a residential property when equitable ownership or legal ownership of the property is passed to the person. A person "disposes of" a property when equitable ownership or legal ownership of the property passes from that person to another person. According to the Administration, a person "acquires" a property if he enters into a specifically enforceable agreement for the sale or purchase of that property.

16. Some members have enquired whether a Provisional Agreement for Sale and Purchase (PASP) is a specifically enforceable agreement. According to

the Administration, a specifically enforceable agreement is one that parties may rely on to apply to the court for specific performance to compel the other party to sell or purchase the property. Specific performance is a discretionary remedy and will not be granted if it is considered that compensation would be an adequate remedy. Therefore, whether a PASP is a specifically enforceable agreement in respect of the sale or purchase of the property depends on the terms stated in the agreement. In general, most PASPs are not specifically enforceable agreements as formal Agreements for Sale and Purchase (ASPs) will be required for the transfer of ownership of the properties. While it is a normal practice for an ASP to be executed within 14 days from the signing of PASP, members have pointed out that there are cases where ASP has not been entered into due to disagreement to certain terms and conditions. The transaction is still completed according to PASP. Under such circumstances, PASP is treated as a binding agreement. Hence, there is a need to clarify whether a PASP entered into before 20 November 2010 is specifically enforceable, as this will affect the determination of the holding period of 24 months.

17. Taking into account the Bills Committee's views, the Administration has agreed to set out in more explicit terms as to how the date of acquisition and disposal of ownership for the purpose of charging SSD should be determined. Premised on the principle that a person "acquires" or "disposes of" a property when equitable ownership or legal ownership of the property is passed, the Administration has proposed to introduce Committee Stage amendments (CSAs) such that the acquisition and disposal dates of a property will be based on the signing date of the chargeable agreement for sale, or if no such chargeable agreement exists, the signing date of conveyance (i.e. Assignment). For the purpose of determination of the date of acquisition or disposal, chargeable agreements include those "agreements for sale" as defined in section 29A of SDO, except those instruments as defined under paragraph (b) of the definition of "agreement for sale" in section 29A(1) of SDO. Where there is more than one chargeable agreement for sale in a transaction, the signing date of the earliest agreement will be taken as the date of acquisition or disposal of the property.

18. Some members have enquired about the reason for excluding an instrument which confers an option or a right to purchase immovable property or a right of pre-emption in respect of immovable property (an instrument as defined under paragraph (b) of the definition of "agreement for sale"). They are concerned that the proposed exclusion might inadvertently result in a loophole for speculation on such option with a view to circumventing SSD. The Law Society of Hong Kong (LS) has also pointed out the need for tighter wordings to precisely reflect the intent of the exclusion because "agreement for sale" as described in paragraph (b) of its definition in section 29A(1) of SDO

includes "an option to purchase immovable property", "a right to purchase immovable property" and "a right of pre-emption in respect of immovable property". While "an option to purchase immovable property" and "a right of pre-emption in respect of immovable property" are clear, "a right to purchase immovable property" appears to overlap with the "agreement for sale" as defined under paragraph (a) of the definition of "agreement for sale" in section 29A(1) of SDO which is an instrument not covered by the proposed exclusion.

19. According to the Administration, the reason to exclude an instrument which confers an option to purchase immovable property or a right of pre-emption in respect of immovable property is because "equitable ownership" does not pass from the vendor to the purchaser upon granting of such an option or right. In other words, the purchaser is not considered under the Bill as having "acquired" the property. Besides, the majority of PASPs currently used in the market do not fall under this category. Following the disallowance of confirmor transactions of first-hand uncompleted properties with pre-sale consent granted on or after 13 August 2010, purchasers are no longer allowed to re-sell, sub-sell or transfer the benefits of PASPs/ASPs before completion of Assignment. Notwithstanding, the Administration has taken into account LS's views and made it clear that, for the purpose of determination of the date of acquisition or disposal, chargeable agreements include those "agreements for sale" as defined in section 29A of SDO, except "an option to purchase immovable property" and "a right of pre-emption in respect of immovable property" as referred to in paragraph (b) of the definition of "agreement for sale" in section 29A(1) of SDO. In gist, when there is a signed PASP, the signing date of the PASP (other than an instrument which confers an option to purchase or a right of pre-emption) will be the date of acquisition or disposal of the property for the purpose of calculating the holding period of the residential property. For an instrument which confers an option to purchase or a right of pre-emption, the date of signing of ASP or the Assignment (if there is no ASP) will be the date of acquisition or disposal of the property.

20. Bills Committee members remain of the view that such exclusion will create possible loophole for speculators to avoid SSD in future. To address members' concerns, the Administration has proposed revised CSAs to remove "an option to purchase immovable property" and "a right of pre-emption in respect of immovable property" from the definition of "agreement for sale".

21. The Bills Committee has sought clarification on whether a bona fide mortgage (or charge) is a chargeable agreement. The Administration has advised that all along, IRD takes the view that a bona fide mortgage (or charge) does not fall within the definition of "agreement for sale" as it confers no immediate or automatic right of sale of the property. Instead, the mortgagee

will exercise its rights only in the case of a mortgagor's default. Hence, a bona fide mortgage (or charge) is not considered as an agreement for sale as defined and therefore is not chargeable with ad valorem stamp duty. This is set out in the "Stamp Office Interpretation and Practice Notes No. 1 (Revised) – Stamping of Agreements for Sale and Purchase of Residential Property" (Practice Notes). The position of IRD is well understood by the relevant professions. So far, no practicable difficulties have been encountered. By the same token, a bona fide mortgage (or charge) would not be chargeable with SSD. When calculating the holding period of a mortgaged property, the date of a bona fide mortgage (or charge) is not a relevant consideration. The holding period will count from the date when the property owner acquires the property to the date when the property owner disposes of the property.

22. For the sake of clarity, some members have requested the Administration to amend the Bill to make it clear that both ad valorem stamp duty and SSD will not apply to a bona fide mortgage (or charge). According to the Administration, the definition of "agreement for sale" in SDO is an anti-tax avoidance provision with the purpose of catching any "agreement for sale" under the disguise of mortgage (incorporating an irrevocable power of attorney) to not only provide security for money advanced but also gives, expressly or impliedly, an immediate and automatic right of disposal of a residential property. Amending this may create loopholes for speculation. Notwithstanding, IRD will update the Practice Notes upon enactment of the Bill to explicitly state that a bona fide mortgage (or charge) is not considered as an agreement for sale as defined and therefore is not chargeable with SSD.

Liability for SSD

23. Under the existing SDO, all the parties executing a chargeable instrument are jointly and severally liable to pay the stamp duty.

24. Given that the objective of SSD is to deter speculation, some members have enquired if consideration can be given to only holding the seller liable for SSD. The Administration has explained that holding all the parties jointly and severally liable for the stamp duty is one of the fundamentals of the Hong Kong stamp duty regime. While it has been the market practice for buyers to pay the current ad valorem stamp duty, this may not necessarily be the case upon the implementation of SSD because buyers can choose to buy properties which have been held for more than 24 months instead. For transactions on properties which have been held for shorter than 24 months, buyers and sellers will negotiate on which party should pay the stamp duty, including SSD. Besides, the proposal to hold the sellers alone liable for SSD will not have much practical effect in protecting the buyers because an instrument has to be duly stamped in order to be registered with the Land Registry. Therefore, the

buyers will have to pay SSD if the sellers fail to do so in order to have the instrument registered with the Land Registry for protection of title.

Provisions for exemptions

25. The Bill provides that exemption from payment of SSD can be granted to the disposal of residential properties acquired on or after 20 November 2010 and resold within 24 months or less under various specific circumstances, namely –

- (a) nomination of a close relative (i.e. spouse, parent and child) to take up the assignment of the property and resale or transfer of the property to a close relative;
- (b) transfer between associated companies;
- (c) sale of property due to bankruptcy/involuntary winding up; and
- (d) sale of property to the Government.

While the Bill does not provide for exemptions to transactions of residential properties which are acquired on or after 20 November by a beneficiary of a deceased person and resold in 24 months or less, the Bill provides a concession that, for the purpose of counting the holding period of the property, the date of acquisition of the property by the deceased person will be deemed to be the date on which the beneficiary acquires the property.

Involuntary sale or transfer of properties made by the courts or pursuant to court orders/involuntary sale of mortgaged properties in various forms

26. The Bills Committee has noted that apart from bankruptcy/involuntary winding up, many deputations have requested the Administration to grant exemption to involuntary sale of properties within 24 months of acquisition in various forms as the sale of properties under such circumstances is not speculative in nature. These include enforcement actions by mortgagee, receiver sale, foreclosure order and equitable mortgagee, court order for sale of property, sale of property under a compulsory sale order granted under the Land (Compulsory Sale for Redevelopment) Ordinance (Cap. 545) (LCSRO), matrimonial home in consequence to divorce etc.

27. Having considered views of the Bills Committee and deputations, the Administration has proposed CSAs to grant exemptions under the following circumstances, namely –

- (a) involuntary sale or transfer of property made by or pursuant to a court order (including a foreclosure order obtained by a mortgagee (being a financial institution within the meaning of section 2 of the Inland Revenue Ordinance (Cap. 112) (IRO)) or receiver but does not include a compulsory sale order granted under LCSRO);
- (b) involuntary sale of mortgaged properties in various forms by a mortgagee which is a financial institution within the meaning of section 2 of IRO, or by a receiver appointed by such a mortgagee for the purpose of enforcing the mortgage; and
- (c) resale of property by financial institutions or receivers to which the legal ownership of the property has been passed in a foreclosure order.

However, the Administration does not intend to exempt SSD in respect of the compulsory sale of properties under a compulsory sale order granted under LCSRO as the possibility of speculation in the transactions cannot be ruled out.

28. In respect of the exemption granted to involuntary sale of mortgaged properties by a mortgagee, some members have enquired if money lenders fall under the definition of financial institution within the meaning of section 2 of IRO. They have pointed out that exercising the mortgagee's power to sell is a common way for money lenders to recover the outstanding loans in the case of default payment. The Administration has advised that financial institutions under section 2 of IRO are authorized institutions under the Banking Ordinance (Cap. 155), or associated corporations of such authorized institutions, and all of them are subject to a high level of regulation and monitoring under HKMA on financial prudence and professionalism in business practices. Mortgagees which do not fall under this definition are principally holders of money lenders' licences not subject to the regulation of HKMA. The restriction is considered necessary to safeguard against abuse. In the light of members' concern, the Administration has proposed revised CSAs to delete the exclusion of a foreclosure order obtained by a mortgagee which falls outside the definition of a financial institution within the meaning of section 2 of IRO from the exemption to be granted to involuntary sale or transfer of properties made by the courts or pursuant to court orders, given that the risk of abuse of court proceedings should be low.

29. The Bills Committee has questioned the rationale for not exempting the compulsory sale of properties under a compulsory sale order granted under LCSRO, as it would not be fair to require genuine minority owners who have unknowingly purchased a property less than 24 months before the lot is put to compulsory sale to pay SSD. It is also suggested that consideration should be

given to exempting the minority owners who are unwilling but forced to sell their properties involuntarily under a compulsory sale order granted under LCSRO. The Administration has reiterated that it cannot rule out the possibility of speculation in respect of the compulsory sale of properties under a compulsory sale order granted under LCSRO. Exempting compulsory sale of properties under a compulsory sale order granted under LCSRO may attract speculation in flats in buildings with high redevelopment potential, given that the cost of speculation will be lower for these flats as compared with other flats. For genuine minority owners who have unknowingly purchased a property less than 24 months before the lot is put to compulsory sale (and before an application for compulsory sale is even filed with the Lands Tribunal such that no public channel is available for the genuine minority owners to ascertain whether the lot is a target of compulsory sale application), they will have an opportunity to make representation to the Lands Tribunal on the draft conditions of sale to be prescribed in the compulsory sale order to be granted, including any representation on who should pay SSD. The proposed amendments to SDO to introduce SSD will not affect the power of the Lands Tribunal under section 4(6)(a)(i) of LCSRO to give directions, including the settling of the conditions of sale.

30. In the light of members' repeated requests, the Development Bureau (DevB) has been further consulted on the feasibility of exempting minority owners from payment of SSD on ground that they are being forced to sell their flats involuntarily. According to DevB, the existing mechanism for the Lands Tribunal to give directions on the conditions of sale under a compulsory sale order has been working well since LCSRO came into operation. In all the past 24 cases where land lots were successfully sold under compulsory sale orders, the Lands Tribunal had directed that all stamp duties should be paid by the purchasers of the land lots. Nonetheless, taking into members' views and the overall policy direction to grant exemption to involuntary sale or transfer of properties made by the courts or pursuant to court orders, DevB has agreed to extend the exemption to cover LCSRO cases. However, such exemption should be an outright exemption, covering both the majority owners and the minority owners involved, as the possibility that the majority owners are made up of individual small owners coming together to apply for a compulsory sale under LCSRO cannot be ruled out. Not to exempt such sale properties by these majority owners from payment of SSD may discourage them from applying for compulsory sale under LCSRO for redevelopment purposes. Besides, while the majority owners are the applicant for compulsory sale of the lot for redevelopment, they may not necessarily be the purchaser of the lot at the auction ordered by the Lands Tribunal. If the majority owners participate in the auction are out-bidden, they will be forced to sell the undivided shares that they have already acquired when making the application for compulsory sale under LCSRO. Therefore, if the reason for exempting the minority owner is

involuntary sale, the majority owners in such cases should also be exempted from payment of SSD.

Sale or transfer of a residential property by a beneficiary whose property is inherited from a deceased person's estate

31. The Bills Committee has noted that when an individual inherits a property from a deceased person, the assent which vests legal ownership of the property from the deceased person to the beneficiary is not chargeable with stamp duty under the existing SDO. By the same token, the assent is not chargeable with SSD. However, if the beneficiary sells the inherited property in 24 months or less counting from the date of acquisition of the property by the deceased person, the transaction is subject to SSD. Given that a beneficiary has inherited rather than acquired the property on his own accord, some members have questioned why the sale of inherited property by the beneficiary should be caught by SSD. In the light of members' concern and given the remote risk of abuse under inheritance case, the Administration has agreed that the sale or transfer of a residential property by a beneficiary whose property is inherited from a deceased person's estate should be exempted from payment of SSD. The Administration has proposed CSAs to this effect.

Sale or transfer of bare sites and first-hand residential units

32. The Bills Committee has noted the concerns of some deputations about the effect of SSD on flat supply in the residential market as owners may tend to hold their properties longer in order to avoid payment of SSD. There are also concerns about the application of SSD to the sale/transfer of bare sites and sale/disposition of first-hand residential units. The Administration has advised that it is not the policy intention to apply SSD to the sale of first-hand residential properties. Under the Bill, SSD will be chargeable in respect of the disposal of a residential property within 24 months beginning on the day on which the property is acquired by the vendor under a chargeable agreement for sale or under a conveyance. This means that the vendor will have to "acquire" the property and then "dispose of" the same property within 24 months after acquisition. In the case where a developer acquires a bare site from the Government, builds residential units on the bare site, and then sells the residential units to the public, the sale of the residential units thereon is not chargeable with SSD even if the duration falls within 24 months. Under the SSD regime, SSD will be chargeable in respect of the disposal of a property which is acquired by the vendor under a chargeable agreement for sale or under a conveyance. Conditions of Sale (in the case of public auction/tender) or Conditions of Exchange (in the case of land exchange) is neither a chargeable agreement nor a conveyance. For the purpose of SSD, there will be no "acquisition" by the developer and thus the disposal of the first-hand residential

properties by the developer will not be chargeable with SSD. The individual buyers of the residential units thereon "acquire" the residential units and when the individual buyers sell their units, the dates of transactions will be taken as the dates of "acquisition" of and the "disposal of" the properties concerned, and SSD will apply if the transaction takes place within 24 months. For the sake of clarity, the Administration will move CSAs to clearly reflect the policy intent in the Bill.

33. Some members have however pointed out that there are cases where developers purchase land (such as redeveloped sites) from other developers. The Administration has explained that when a developer purchases a bare site, builds on it, and then sells the flats built thereon within 24 months, SSD is not applicable regardless of whether the developer purchases the piece of land from the Government or from another developer. This is because the units built on a bare site/redeveloped site are not the same residential property concerned as the bare site/the original properties acquired and demolished by the developer/vendor. It is only under the scenario where developer A acquires a bare site not from the Government, and instead of building on it, sells/transfers the bare site to developer B within 24 months that SSD will be chargeable since developer A has "acquired" the bare site and subsequently "disposed of" it. Some members have questioned the different application of SSD to sale/transfer of land and flats given that the latter is indeed the sale/transfer of the undivided shares of the former. Mr Abraham SHEK has also cautioned that the application of SSD to sale/transfer of bare sites may unduly affect the delivery of flats as developers may tend to hold the sites longer to avoid payment of SSD. There are also cases where developers may have to sell the bare sites due to insufficient capital for development. Besides, the additional cost incurred from SSD will eventually be transferred to consumers. The Administration has advised that it is not appropriate to provide a specific exemption for this scenario as the possibility of speculation cannot be ruled out, and that a specific exemption for this scenario can send a wrong message and create loopholes. Under the Bill, transfer (including bare sites) between associated companies is already exempted from payment of SSD. Developers should be able to flexibly adjust their business strategies and operation in the light of the new taxation environment after enactment of the Bill without affecting the supply.

34. Mr Abraham SHEK is not convinced of the Administration's response. He has indicated his intention to move CSAs to the effect that SSD is not chargeable if a person "acquires" a residential property comprising land without any building erected thereon and "disposes of" of the property before any building is erected on the land within the 24-month period, and that the date of acquisition by a transferor of a residential property under an instrument not chargeable with stamp duty by virtue of section 29H(3) or 45 of SDO shall be deemed to be the date on which the transferee under the instrument has acquired

the property.

Addition/deletion of names when executing a chargeable agreement or Assignment

35. The Bills Committee has enquired about the application of SSD in the case of addition or deletion of names when executing a chargeable agreement or Assignment. The Administration has advised that under the existing SDO, chargeable agreements or Assignments with names of purchasers added or deleted will be subject to ad valorem stamp duty except for cases where the persons added or deleted are spouses, parents or children of the original purchaser(s). The same principle will apply to SSD. Given that adding names in different stages of a property transaction is a common market practice, and that the adding of names does not involve speculation in cases involving brothers and sisters, members have asked whether this could be exempted from payment of SSD. According to the Administration, the application of SSD to addition/deletion of names to/from a chargeable agreement or Assignment is an anti-tax avoidance measure. It will create a big loophole for speculation if exemption were extended to cover, say, unmarried couples, other relatives, and business partners. An illustration on how speculators may avoid SSD in full or in part if adding names are exempted from SSD is given in **Appendix III**. The Administration has advised that it will enhance public education and publicity efforts to remind home purchasers of the need to pay SSD, if non-exempted persons are to be added to or deleted from a chargeable agreement or Assignment in 24 months or less counting from the date of acquisition of the property by the original purchaser(s). Upon the passage of the Bill, IRD will update its Practice Notes to solicitors and estate agents. Frequently asked questions will also be uploaded onto IRD's websites for public reference.

36. Some members remain of the view that siblings should be included in the exempted group of close relatives, given that siblings are entitled to inheritance of estate. On the premises that the sale or transfer of properties among brothers and sisters are rarely speculative in nature and the relationship is readily ascertainable, and that the impact and risk of abuse is low, the Administration has agreed that SSD should not apply to the case of addition/deletion of name if the person is a brother or sister of the original purchase. By the same token, the nomination of brothers and sisters to take up assignment of a property and the resale or transfer of the property to brothers and sisters will also be exempted from payment of SSD. The Administration has proposed CSAs to these effects. In response to members' question on whether the reference to the terms "parent", "spouse", "child", "brother" and "sister" in the proposed CSAs include those who are not blood-related, half blood-related, and adopted, the Administration has advised that these terms are not specifically defined in SDO or the Interpretation and General Clauses

Ordinance (Cap. 1). Taking into account the need that the relationship has to be readily ascertainable, IRD will accept persons who are blood-related, half-blood related, adopted or step-related for SSD purposes. IRD will set out the scope of application in the Practice Notes upon enactment of the Bill.

Further exemptions

37. Bills Committee members are concerned about the genuine cases where owners have to sell their properties within 24 months of acquisition due to substantial changes of circumstances, such as unforeseen financial difficulties and severe illness. They have requested the Administration to expand the scope of exemptions to include these cases. Consideration should also be given to providing an appeal mechanism to assess and decide on the applicability of SSD on a case-by-case basis. The Administration has advised that it is very important that the law should be clear and without ambiguity, and that any exemptions to be considered should be fair and measurable in an objective manner without affecting the effectiveness of SSD. The types of exemptions should be clearly set out in the Bill. Based on these guiding principles, the Administration has proposed additional exemptions as far as possible as set out in the preceding paragraphs. The Administration is not able to accept the proposed setting up of an appeal mechanism to assess and decide on the applicability of SSD on a case-by-case basis in the light of individual circumstances, such as financial hardship or health reasons, because it is a fundamental deviation from the present taxation system where the Commissioner for Inland Revenue has no discretion to waive any types of tax payable. The proposal is considered not practicable for implementation and will likely create loopholes for speculators to circumvent SSD, thereby undermining its effectiveness.

Efficacy of SSD in curbing speculation in residential properties

38. While acknowledging that the number of property transactions has dropped soon after the announcement of SSD, the Bills Committee has noted that such effect seems to have faded away as evidenced by the recent rise in property prices. Given that speculators may circumvent SSD by setting up property holding shell companies to conduct speculation through transfer of shares of these companies, members have enquired if there is an increase in the number of shell companies and property transactions through these companies after announcement of SSD.

39. According to the Administration, the basket of measures (including SSD) which has been introduced will change market expectation. With diminished prospect for quick profits from speculating in Hong Kong properties, there will be less speculation by individuals, Hong Kong companies or foreign companies.

IRD has been closely following up property transactions entered in names of individuals or companies. IRD will continue to enforce the law and collect profits tax from these individuals and companies. For sale and purchase of Hong Kong stocks, including shares of "property holding companies" registered in Hong Kong, both the seller and the buyer of Hong Kong stocks are liable to stamp duty based on the price paid (or the market value of the shares if the price paid are considered substantively below the market value). IRD has been actively tracking and taking follow-up actions on property speculation cases, including cases involving transfer of shares of "property holding companies", to ensure that profits derived from property speculation are duly taxed. When stamping the transfer of shares in private companies, IRD's Stamp Office will refer suspected shares transfer cases of "property holding companies" to the Assessing Unit for review. Since April 2010, the Stamp Office has compiled statistics on those suspected speculation cases in the form of transfer of shares of "property holding companies" and those cases which have been referred to the Assessing Unit for follow-up actions. IRD will continue to keep track of the situation.

40. Since SSD will not only affect speculators but also genuine home buyers, some members have opined that the imposition of a punitive profits tax (say 90%) may be a better alternative to curb speculation while minimizing the impact on genuine home buyers. The Administration has advised that SSD is applicable to the sale of residential properties within 24 months after acquisition regardless of whether the transactions generate profits, whereas profits tax only applies to transactions which generate profits. Profits tax is levied on the net profits (after taking into account the losses, if any) accrued to an individual or a company on the basis of the year of assessment. The Administration is of the view that SSD, as compared with "profits tax", is a more targeted and effective measure to curb short-term speculation. To facilitate better understanding, some examples to illustrate the calculation method, payment period and the amount of tax payable in terms of SSD and a profits tax at 90% are given in **Appendix IV**.

The need for sunset clause for SSD

41. Given the undesirable impacts of SSD on genuine home buyers as well as flat supply in the residential property market, and that SSD may not be required if the low interest rate environment and the inflow of funds no longer prevail, some members have enquired whether consideration can be given to including in the Bill a sunset clause/an extension mechanism. According to the Administration, a date for the SSD-related provisions to lapse would need to be specified if a sunset clause is to be included in the Bill. However, it is not possible for the Administration to pre-determine a date when SSD is deemed no longer necessary to curb speculation, and any attempt to do so will send a

wrong message and add volatility to the market. The Administration considers that the inclusion of a sunset clause/an extension mechanism in the Bill will undermine the effectiveness of SSD, as speculators would know or speculate on the time frame when SSD lapses, and this will add volatility to the market. The Administration intends to go through the normal legislative process to amend the legislation when SSD is considered no longer necessary.

42. The Bills Committee has enquired about the factors which the Administration will take into account in determining when SSD is no longer necessary. The Administration has advised that it will taken into account all relevant factors, both internal and external, including the risk of a property bubble, the exuberant state of the property market in particular the mass market, the severity of short-term speculative activities, global liquidity, interest rates, as well as policies adopted and measures taken by other economies which may have an adverse impact on the healthy and stable development of the local property market. It is not possible for the Administration to state in precise term or set specific targets as to the circumstances under which it will do away with SSD. Given the volatility of the property market, the Administration will respond to the changing market flexibly and swiftly. In the light of members' repeated requests, the Administration has undertaken to review SSD once every 24 months after the enactment of the Bill, or as circumstances require.

43. Mr Abraham SHEK has expressed concern about the lack of a mechanism for LegCo to review the continued need for SSD. Although SSD is meant to be a draconian measure to curb speculation, the Bill as drafted will make SSD a regular tax which will affect many genuine home buyers and undermine the reputation of Hong Kong as a free-market economy. While the Administration has undertaken to review SSD once every 24 months or as circumstances require after enactment of the Bill, it is under no compulsion to do so nor can LegCo compel the Administration to do so. In his view, a sunset clause will ensure that the Administration will review SSD and put forward its recommendation to LegCo, failing which SSD shall cease to apply. The decision on whether SSD should continue will rest with LegCo. He has indicated his intention to move CSAs to the effect that the Stamp Duty (Amendment) (No. 2) Ordinance 2010, if enacted, shall expire at midnight on 19 May 2012, and that LegCo may by resolution amend subsection (1) by substituting the date specified therein such date as may be specified in the resolution.

44. The Bills Committee has also examined other aspects of the Bill and raised no objection.

Committee Stage amendments

45. The Bills Committee has no objection to the CSAs to be moved by the Administration, and will not move any CSAs in its name. However, Hon Abraham SHEK has indicated intention to move CSAs to the Bill.

Recommendation

46. The Bills Committee supports the Administration's proposal to resume the Second Reading debate on the Bill on 22 June 2011.

Consultation with the House Committee

47. The House Committee at its meeting on 10 June 2011 supported the recommendation of the Bills Committee in paragraph 46.

Prepared by
Council Business Division 1
Legislative Council Secretariat
16 June 2011

Bills Committee on Stamp Duty (Amendment) (No. 2) Bill 2010

Membership list

Chairman Hon James TO Kun-sun

Members Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon Margaret NG
Hon CHAN Kam-lam, SBS, JP
Hon Miriam LAU Kin-ye, GBS, JP
Hon Abraham SHEK Lai-him, SBS, JP
Hon Audrey EU Yuet-mee, SC, JP
Hon WONG Kwok-hing, MH
Hon LEE Wing-tat
Dr Hon Joseph LEE Kok-long, SBS, JP
Hon WONG Ting-kwong, BBS, JP
Hon Ronny TONG Ka-wah, SC
Hon CHIM Pui-chung
Hon Starry LEE Wai-king, JP
Hon Paul CHAN Mo-po, MH, JP
Hon Paul TSE Wai-chun
Hon Alan LEONG Kah-kit, SC
Hon Tanya CHAN (up to 9 February 2011)

(Total : 18 Members)

Clerk Miss Becky YU

Legal Adviser Miss Winnie LO

Date 9 February 2011

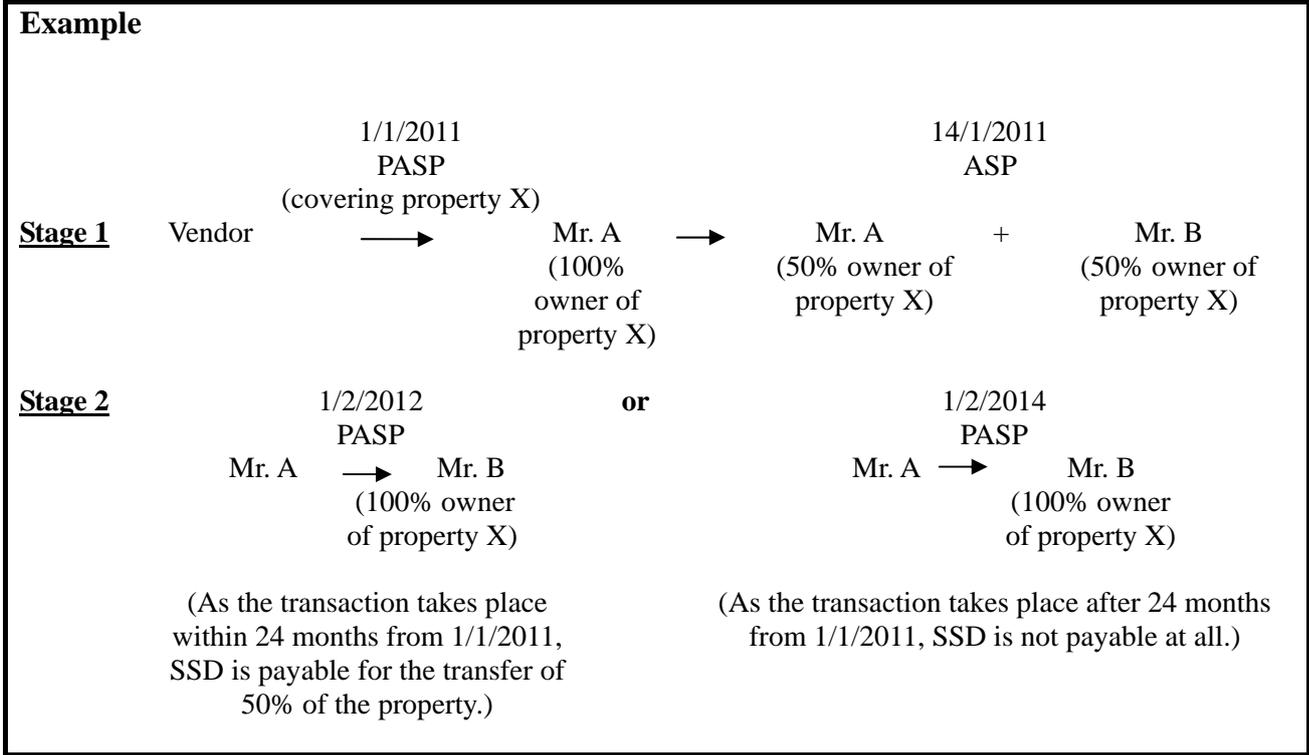
Appendix II

List of organizations/individuals which/who have made written and/or oral representations to the Bills Committee

- (1) Association of Chartered Certified Accountants Hong Kong
 - (2) Century 21 Goodwin Property Consultants
 - (3) Chu & Lau Solicitors & Notaries
 - (4) Hong Kong Chamber of Professional Property Consultants Ltd
 - (5) Hong Kong Institute of Estate Agents
 - (6) Hong Kong Institute of Real Estate Administrators
 - (7) Hong Kong Owners Club
 - (8) Hong Kong Real Estate Agencies General Association
 - (9) Lion Rock Institute
 - (10) Momentum 107
 - (11) PricewaterhouseCoopers Ltd
 - (12) Property Agencies Association
 - (13) Property Agents Association
 - (14) Society of Hong Kong Real Estate Agents Ltd
 - (15) Tai Hung Fai Enterprise Co Ltd
 - (16) Tony Kan & Co Solicitors & Notaries
 - (17) The Hong Kong Association of Banks
 - (18) The Hong Kong Conveyancing and Property Law Association Ltd
 - (19) The Hong Kong Institute of Surveyors
 - (20) The Law Society of Hong Kong
 - (21) The Real Estate Developers Association of Hong Kong
 - (22) Webb-site.com
- 3 individual members of the public

**Illustration of how speculators can avoid SSD
if addition of names is exempted**

(Annex B to LC Paper No. CB(1) 1689/10-11(03) refers)



**Illustrative examples to compare
the calculation method, payment period and the amount of tax payable
in terms of the SSD and a profits tax at 90%**

(Annex to LC Paper No. CB(1) 1125/10-11(01) refers)

Individual	Sole Proprietorship	Company																				
<ul style="list-style-type: none"> Mr. A acquired a residential property at \$10 million on 1 December 2010 and disposed of it at \$12 million on 10 January 2011 (i.e. held for less than 6 months). Mr. A did not have any salaries, rental or other business income for the year ended 31 March 2011. 		<ul style="list-style-type: none"> Company A acquired a residential property at \$10 million on 1 December 2010 and disposed of it at \$12 million on 10 January 2011 (i.e. held for less than 6 months). The accounting period of Company A runs from 1 April to 31 March. Company A did not have any other business activity during the basis period. 																				
<p>Special Stamp Duty (SSD)</p> <ul style="list-style-type: none"> Tax rate: 15% Deadline for stamping and payment of SSD: 9 February 2011 (i.e. 30 days from 10 January 2011) SSD liability: \$12 million x 15% = \$1,800,000 																						
<p>Profits Tax</p> <ul style="list-style-type: none"> Issue Date of “Tax Return – Individuals” (“TRI”): 3 May 2011 Deadline for filing TRI: 3 June 2011 Deadline under block extension scheme: 4 October 2011 <p><i>(Note: To allow business operators sufficient time to prepare accounts, normally, the deadline for submission of return for cases involving sole proprietorship business account is 4 October of a year.)</i></p> <ul style="list-style-type: none"> Date of Profits Tax Assessment: 20 October 2011 Due date for payment of profits tax: 6 December 2011 		<p>Profits Tax</p> <ul style="list-style-type: none"> Issue Date of “Profits Tax Return” (“PTR”): 1 April 2011 Deadline for filing PTR: 1 May 2011 Deadline under block extension scheme: 15 November 2011 <p><i>(Note: To allow sufficient time for company to prepare accounts and to have the accounts audited, the deadline for submission of return for companies with accounting year ending on 31 March of a year is 15 November of that year.)</i></p> <ul style="list-style-type: none"> Date of Profits Tax Assessment: 20 November 2011 Due date for payment of profits tax: 2 January 2012 																				
<p>Calculation of Assessable Profits:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Selling price</td> <td style="text-align: right;">\$12,000,000</td> </tr> <tr> <td><u>Less:</u> (a) Purchase Cost</td> <td style="text-align: right;">10,000,000</td> </tr> <tr> <td> (b) Ad Valorem Duty</td> <td style="text-align: right;">375,000</td> </tr> <tr> <td> (c) Agency fee</td> <td></td> </tr> <tr> <td> – on acquisition</td> <td style="text-align: right;">100,000</td> </tr> <tr> <td> – on disposal</td> <td style="text-align: right;">120,000</td> </tr> <tr> <td> (d) Legal expenses (say)</td> <td></td> </tr> <tr> <td> – on acquisition</td> <td style="text-align: right;">10,000</td> </tr> <tr> <td> – on disposal</td> <td style="text-align: right;">10,000</td> </tr> <tr> <td>Assessable Profits</td> <td style="text-align: right; border-top: 1px solid black;">\$1,385,000</td> </tr> </table>			Selling price	\$12,000,000	<u>Less:</u> (a) Purchase Cost	10,000,000	(b) Ad Valorem Duty	375,000	(c) Agency fee		– on acquisition	100,000	– on disposal	120,000	(d) Legal expenses (say)		– on acquisition	10,000	– on disposal	10,000	Assessable Profits	\$1,385,000
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Assessable Profits	\$1,385,000																					

Calculation of Tax Liability:																								
<p>If Mr. A elects Personal Assessment (PA), the tax liability will be as follows:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;">Assessable profits</td> <td style="width: 15%; text-align: right;">1,385,000</td> <td style="width: 10%;"></td> </tr> <tr> <td>Less: Basic allowance (assuming he is single)</td> <td style="text-align: right;">108,000</td> <td></td> </tr> <tr> <td>Net chargeable income</td> <td style="text-align: right; border-top: 1px solid black;">\$1,277,000</td> <td></td> </tr> <tr> <td>PA Tax thereon</td> <td style="text-align: right; border-top: 1px solid black; border-bottom: 3px double black;">\$205,090</td> <td></td> </tr> </table>	Assessable profits	1,385,000		Less: Basic allowance (assuming he is single)	108,000		Net chargeable income	\$1,277,000		PA Tax thereon	\$205,090		<p>Profits Tax liability (\$1,385,000 x 90%) <u>\$1,246,500</u></p> <p>Note: If Mr. A is qualified for Personal Assessment (PA) (See Explanatory Note), the tax liability will be the same as that of an individual (i.e. \$205,090)</p>	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%;">Profits Tax liability (\$1,385,000 x 90%)</td> <td style="width: 30%; text-align: right; border-bottom: 3px double black;">\$1,246,500</td> </tr> </table> <p>Note: The profits tax liability may be further reduced if Company A has loss brought forward (say, \$0.5 million) from back years or sustained losses from other business activities during the same year-</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%;">Profits on disposal</td> <td style="width: 30%; text-align: right;">1,385,000</td> </tr> <tr> <td>Less: Loss brought forward or sustained during the year</td> <td style="text-align: right;">500,000</td> </tr> <tr> <td>Net assessable profit for the year</td> <td style="text-align: right; border-top: 1px solid black;">\$885,000</td> </tr> </table> <table style="width: 100%; border-collapse: collapse; margin-top: 10px;"> <tr> <td style="width: 70%;">Profits Tax liability (\$885,000 x 90%)</td> <td style="width: 30%; text-align: right; border-bottom: 3px double black;">\$796,500</td> </tr> </table>	Profits Tax liability (\$1,385,000 x 90%)	\$1,246,500	Profits on disposal	1,385,000	Less: Loss brought forward or sustained during the year	500,000	Net assessable profit for the year	\$885,000	Profits Tax liability (\$885,000 x 90%)	\$796,500
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Profits Tax liability (\$885,000 x 90%)	\$796,500																							

Explanatory Note: The elector of Personal Assessment must fulfil the following conditions:

- The elector must be of or above the age of 18, or under the age of 18 and both his / her parents are dead; and
- The elector or his / her spouse (if married) is either a permanent or temporary resident in Hong Kong. ('Permanent resident' means the elector or his / her spouse who ordinarily resides in Hong Kong. 'Temporary resident' means the elector or his / her spouse who stays in Hong Kong for more than 180 days during the year of assessment in respect of which the election is made or for more than 300 days in 2 consecutive years of assessment one of which is the year of assessment in respect of which the election is made.)