

**The Administration's response to the issues raised at
the meeting of the Bills Committee on the Stamp Duty (Amendment)
Bill 2012 held on 8 April 2013**

This paper is in response to the issues raised in the letter dated 9 April 2013 from the Legislative Council Secretariat (LC Paper No. CB(1)873/12-13(01) refers).

BSD Refund mechanism for redevelopment activities

2. The policy intent is that the Buyer's Stamp Duty (BSD) should not hinder redevelopments. Under the Stamp Duty (Amendment) Bill 2012 (the Bill), a refund mechanism has been proposed so that acquisitions of residential properties for redevelopment purpose (whether the residential property acquired is for redevelopment into a residential or a non-residential property) will be refunded of the BSD paid, provided that the immovable properties being constructed are completed within six years, with extension allowed in specific circumstances. For BSD purposes, our proposal is that the "six-year period" will start counting when the relevant developer has become the owner of the entire lot of the redevelopment concerned. The developer will be considered to have completed the construction if it has obtained, within six years thereafter, the Occupation Permit (OP) in respect of the redevelopment, or the first OP if there is more than one for the entire redevelopment.

3. We would like to emphasise that the proposed "six-year" period is not set on an arbitrary basis. In formulating the mechanism, we have made reference to the redevelopment timeframe set out under the Land (Compulsory Sale for Redevelopment) Ordinance (Cap.545), which stipulates that the redevelopment of the lot sold under an order granted under that Ordinance shall be completed and made fit for occupation within six years after the date on which the purchaser of the lot became the owner of the lot. We have also made reference to the building covenants stipulated in the land grants, which require the lot owners to complete the developments concerned within the specified periods, generally four to six years.

4. To facilitate redevelopments, once the development has been issued with its first OP within the "six-year period", this will be regarded as satisfying the refund requirement and a full refund will be granted for all phases in the redevelopment. In short, we consider that the proposed

mechanism will not block redevelopments and should be flexible enough to cater for the actual operation of redevelopments.

5. We note the suggestions to advance the refund of the BSD paid for redevelopments, for example, when a developer has accumulated an interest of not less than 80% in a residential building or when the original property has been demolished and the building plan of the redevelopment has been approved. We also note that there is a suggestion to exempt companies from paying the BSD upfront on the condition that the companies concerned undertake (with bank guarantee or other collateral) to pay back the BSD chargeable if the relevant redevelopments are not completed within the “six-year period”. Our view is that, it would be difficult to give any exemption from the BSD before the Inland Revenue Department (IRD) can obtain solid proof that an acquisition is indeed for the purpose of redevelopment and that the developer can subsequently fulfill the various conditions for exemption. While the site or the property concerned may be acquired for redevelopment purposes, there is equal chance that it can be acquired for trading. Therefore, under the mechanism as proposed in our Bill, the person or company pursuing redevelopment has to pay the BSD upfront as and when individual units are acquired. However, once the development has been issued with the first OP within the “six-year period”, it will be regarded as satisfying the refund requirement. We consider that our proposed arrangement under the Bill could avoid any risk of abuse, has struck the right balance between maintaining the integrity of the BSD regime while not interfering with practical aspects of redevelopment projects.

6. The Administration will continue to listen to the views of Members on this issue.

Exempting companies owned by Hong Kong permanent residents (HKPRs) from the BSD

7. There are views that companies of which all shareholders are HKPRs should be exempted from the BSD by setting out in explicit terms conditions under which exemption would be given, aided with a self-declaration mechanism. As explained in our reply to the Hon James To’s submission (LC Paper No. CB(1)793/12-13(03) refers), we would like to reiterate that applying BSD to all companies is in line with and essential to achieving the policy objectives of cooling down the property market and according priority to the home ownership needs of HKPRs. In law, a company is an entity independent of its shareholders. Under

the legal framework of Hong Kong, we have all along distinguished companies by whether they are established locally or overseas, instead of making reference to the HKPR status of the companies' shareholders. To identify a company for the exemption from the BSD on the basis of the HKPR status of its shareholders will cause confusion to the fundamental legal principle under company law that "a company is an entity independent of its shareholders".

8. Besides, if companies are exempted from the BSD, it would create loopholes and seriously undermine the effectiveness of the BSD in achieving the above policy objectives. This is because where residential property is held by a company, the transfer of ownership in the residential property may effectively be transferred by a transfer of the ownership of the company owning such residential property. The transfer of the ownership of a company may be carried out by various means such as the execution of a nomination, declaration of trust or power of attorney, the allotment of new shares, or the issue of new class of shares, the variation of the right of existing shares etc. In some cases, there is no legal obligation on the parties to notify IRD of the transfer (e.g. the allotment of new shares or the issue of new class of shares). In cases such as execution of trust, the issue of new class of shares or variation of right of existing shares, even after the completion of the said share transfer, the original shareholders may appear to remain or remain as shareholders of the company notwithstanding that the ownership of the company has effectively been transferred to someone else. Under these circumstances, there is no way for IRD to be informed of such transfers if the parties choose not to reveal such transfer for tax evasion purposes. Moreover, in order to unearth any such transfers, IRD has to conduct constant searches of the records of the Companies Registry or make in-depth investigations into the affairs of the parties which is operationally impracticable. Accordingly, IRD will not be in a position to verify the veracity of the self-declaration of the shareholder or to carry out investigations to ensure that the declaration made is eventually honoured. Such difficulties will render the proposed self-declaration mechanism susceptible to abuse.

9. We are not assuming that all companies would abuse the self-declaration mechanism proposed by some Members to circumvent the BSD. However, as a responsible Government, we cannot simply ignore the obvious loopholes that may be created by exempting companies from the BSD, which would undermine the effectiveness of the measure in cooling down the property market and according priority to HKPRs in addressing their home ownership needs.

10. We are also concerned about the impact of exempting companies from the BSD on the effectiveness of the various demand-side management measures which the Administration has introduced. The enhanced SSD, the introduction of the BSD and the increase in the ad valorem stamp duty rates (new AVD) target different demands of different buyers. These measures are interrelated and work collectively to achieve the objectives of combating speculations and managing demand. Under the new AVD regime, in determining whether a HKPR has possessed more than one residential property and hence subject to the new AVD, the residential property held by that HKPR through a company of which he is a shareholder would not be taken into account. If companies of which all shareholders are HKPRs were to be exempted from the BSD, those who wish to possess more than one residential property might simply purchase a residential property in the name of a company without the need to pay the BSD, and at the same time can also circumvent the new AVD when they purchase another residential property in their own names. If so, this would undermine the effectiveness of the new AVD regime. These persons would be able to avoid the BSD and new AVD, which would be inconsistent with the policies behind the series of demand-side management measures and seriously undermine the effectiveness of these measures in achieving their objectives.

11. As regard the Hon Paul Tse's query on the justifications for accepting self-declarations by individual buyers on one hand and rejecting the proposed self-declaration mechanism for the purpose of exempting companies owned by HKPRs from the BSD on the other, we would like to emphasise that the two self-declaration mechanisms are very different in terms of the risk of being abused. As far as the self-declaration for individual buyers under the BSD regime is concerned, it requires individual buyers to declare that each of them is acting on his/her own behalf in a transaction. Based on such a self-declaration, the relevant transaction instrument will be stamped by the IRD and the relevant individual buyer has to register the stamped transaction instrument at the Land Registry with a view to protecting his/her interest. If the relevant individual buyer wishes to transfer the property interest to a non-HKPR without informing IRD, the instrument effecting such a transfer would not be registrable as it is unstamped. In other words, such a transfer would not be entitled to the protection under the Lands Registration Ordinance (Cap.128). As such, we believe that the existing mechanism provides little incentive for individual buyers to abuse the self-declaration system as it will result in forfeiture of the relevant statutory protection.

12. On the other hand, however, the proposed self-declaration by the shareholders for companies is very different. Unlike the self-declarations by individual buyers which refer to existing facts which can easily be verified, the self-declarations by the shareholders concern facts which are difficult to be verified or events which have to be monitored. Further, as mentioned in paragraph 8 above, if the shareholders of a company transfer their ownership in the shares to others by means that do not involve the execution of instruments chargeable to stamp duty (such as by way of allotment of new shares or issue of new class of shares) in order to effectively transfer the ownership in the residential property, IRD would not be in a position to know since no legal obligation is imposed on the parties to such transfer to notify IRD of such transactions. Separately, the shareholders of a company may also effectively transfer their shares by nomination, declaration of trust or power of attorney. These transactions are not legally required to be registered at the Companies Registry. If the parties for tax evasion purpose deliberately withhold the transfer information from IRD's knowledge and withhold the relevant instruments from stamping, then there is no way for IRD to identify these transfers. In view of the above, it is possible for shareholders of a company to effectively transfer ownership in residential property to someone else without the need to execute chargeable instruments that would be required to be brought to the notice of IRD in normal course. This is totally different from the self-declaration system for individual buyers of residential properties as the subsequent transfers by them of the properties would involve execution of chargeable instruments.

13. For example, in order to avoid BSD, an ineligible person may make arrangement for the residential property to be sold first to a corporation owned by HKPRs under his control and then for the ownership in the property to be effectively transferred to him (through the transfer of shares in the corporation) by appropriate means that does not involve the need to execute a chargeable instrument. For reasons mentioned above, IRD will have practical difficulties in identifying such transactions and hence cannot effectively police the due observance of the term of the self-declaration made by the shareholders.

14. We note that some have also queried why declarations made by bodies corporate under section 45 of the Stamp Duty Ordinance (Cap.117) (the SDO) are accepted but the proposed self-declaration mechanism for exempting HKPR-owned companies is not accepted in the present case. To enjoy the stamp duty relief provided under section 45 of the SDO, the

relevant bodies corporate have to be associated body corporate to each other, i.e. one is beneficial owner of not less than 90% of the issued share capital of the other, or a third such body is beneficial owner of not less than 90% of the issued share capital of each. The registration and operation of such bodies corporate are subject to the regulation of the relevant company law. For instance, a body corporate has to declare in its audited financial statement the shares it holds in respect of another body corporate, such that the IRD can rely on to verify their associated body corporate relation as stated in the declaration. However, in the case of the proposed self-declaration mechanism for the purpose of exempting HKPR-owned companies, even if it is adopted, share transfers may still be conducted by “concealed documents” such as declaration of trust where registration with the Companies Registry is not required. Hence, IRD would have no means to enforce compliance.

Exempting charitable bodies which are exempted from tax under section 88 of the Inland Revenue Ordinance (Cap.112) (the IRO) from the BSD

15. Section 88 of the IRO does not prohibit charitable organisations from engaging in activities other than those carried out in pursuance of their charitable objects. Under section 88 of the IRO, only the profits from primary purpose trading carried out by a charity (i.e. trading in the course of the actual carrying out of its expressed charitable objects or trading that is mainly carried out by the beneficiaries of the charity) are exempt from profits tax. The profits from any trading other than primary purpose trading (including that carried out with the sole aim of raising fund of the charity) will be subject to profits tax. On the other hand, under the SDO, only instruments effecting transfers to a charity by way of gift are exempt from stamp duty. In respect of any other chargeable instruments to which a charity is a party, the charity will be liable for the stamp duty payable (which includes the ad valorem stamp duty and the SSD in the case of a transfer of residential property). Exempting charitable bodies from the BSD is contrary to the policy intention of according priority to HKPRs in addressing their home ownership needs in the midst of the tight supply situation and the exuberant property market.

16. Having made reference to the existing ad valorem stamp duty and SSD regimes, the Bill has already proposed to grant exemption from the BSD for gift of residential properties to charitable institutions exempted from tax under section 88 of the IRO. We consider that the

Bill has struck the right balance in addressing the needs of charitable institutions.

Constitutionality of the SSD and the BSD

17. We have consulted the Department of Justice on the constitutionality of the SSD and the BSD, and its views are summarised below.

18. We consider that the SSD and the BSD are constitutional and are legitimate taxations under Article 108 of the Basic Law. In pursuance of Article 108, the Government may, subject to the scrutiny of the Legislative Council, make laws concerning matters of taxation.

19. In response to the enquiry of the Hong Kong Institute of Estate Agents (LC Paper No. CB(1)724/12-13(01) refers), the Administration has explained in LC Paper No. CB(1)770/12-13(02) that the BSD regime does not constitute a breach of Article 25 of the Basic Law. As set out in our response mentioned above, although Article 25 of the Basic Law provides that all Hong Kong residents shall be equal before the law, this guarantee does not invariably require exact equality. Differences in legal treatment may be justified for good reason. Thus, differential treatment may be justified if the difference in treatment pursues a legitimate aim, is rationally connected to the legitimate aim and is no more than is necessary to accomplish that aim.

20. As far as the BSD is concerned, the proposed exemption for HKPR buyers pursues the legitimate aim of meeting the housing and home ownership needs of HKPRs who have a close connection with Hong Kong under the current exceptional circumstances where supply is tight and the property market remains exuberant. There is a genuine need to treat HKPRs differently from other Hong Kong residents. Exempting buyers who are Hong Kong residents but are not HKPRs from the BSD would undermine the effectiveness of the measure in accomplishing that aim. We have also explained above why it is inadvisable to exempt companies owned by HKPRs from the BSD. We consider that the exemption is rationally connected to the legitimate aim and is no more than is necessary to accomplish that aim.

21. The objectives pursued by the SSD are also legitimate. The objectives of the SSD are, through combating short-term speculative activities, to prevent further exuberance in the housing market which may

pose significant risks to our macro economic and financial sector stability and to ensure the healthy and stable development of the residential property market which is crucial to the sustainable development of Hong Kong as a whole. The SSD is rationally connected to these objectives. Indeed, the SSD has been effective in combating short-term speculative activities since its introduction in November 2010. In view of the continued exuberant state of the property market, we have reviewed the SSD and considered that there is a need to further enhance the SSD to provide a stronger disincentive for speculators and short-term investors. We consider that the SSD and the enhancement to the SSD are no more than necessary to achieve the stated objectives.

22. We would like to emphasise that the demand-side management measures, including the SSD and the BSD, are extraordinary measures introduced in response to the present exceptional circumstances. We will continue to closely monitor the private residential property market and consider withdrawing these measures as and when appropriate.

Transport and Housing Bureau
April 2013