



Room 525, 5/F., Prince's Building, Central, Hong Kong
 Telephone: 2521 1160, 2521 1169 Facsimile: 2868 5035
 Email: info@hkab.org.hk Web: www.hkab.org.hk

香港中環太子大廈5樓525室
 電話：2521 1160, 2521 1169 圖文傳真：2868 5035
 電郵：info@hkab.org.hk 網址：www.hkab.org.hk

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(By mtang@legco.gov.hk)

Clerk to the Bills Committee on Stamp Duty (Amendment) (No. 2) Bill 2010
 Legislative Council Secretariat
 Legislative Council Building
 8 Jackson Road
 Central
 Hong Kong

Attn Mrs. Mary TANG / Ms. Mandy POON

Dear Sirs,

RE: Written Submission to the Bills Committee of the Stamp Duty (Amendment) (No. 2) Bill 2010 (defined hereinafter as "Committee" and "Bill")

We write on behalf of the members of the Hong Kong Association of Banks ("HKAB"), being the licensed banks of Hong Kong, to provide a formal written submission in relation to the Bill to this honourable Committee.

Our understanding of the Bill is that it will amend the Stamp Duty Ordinance ("SDO") to provide for: (a) the creation of a new tax of Special Stamp Duty ("SSD"); and (b) the abolition of the existing provisions providing for the deferral of payment of stamp duty.

We set out our comments in relation to the Bill for your consideration:-

1. General Comments

- 1.1. According to the Legislative Council Brief for the Bill prepared by the Transport and Housing Bureau dated 1 December 2010, the objective of the proposed new measures is to "curb short-term speculative activities by substantially increasing the costs to speculators, reduce the risk of the development of an asset bubble and ensure the healthy and stable operation of the property market".
- 1.2. HKAB supports this objective. However, the way SSD is introduced will likely raise problems for our members and for the Hong Kong property, banking and financial industries.

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Vice Chairmen The Hongkong and Shanghai Banking Corporation Ltd
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 秘書 黃美嫦



2. Enforcement of Mortgages

- 2.1. HKAB is particularly concerned with the effect of SSD on the common practice of mortgaged lending for the purchase of residential property, secured on such property.
- 2.2. A mortgage usually falls under one of two categories, either:-
- (a) **a legal mortgage** where the mortgagor is the legal owner of a property and provides security over that property by executing a legal charge over the property; or
 - (b) **an equitable mortgage** where either: (i) the mortgagor is a purchaser under a sale and purchase agreement for the purchase of an uncompleted flat, and as beneficial owner he is entitled to an assignment upon completion of the building subject to payment; or (ii) the mortgagor's interest is merely equitable, and he therefore cannot grant a legal mortgage. The mortgagor therefore grants an equitable charge over his equitable interest.

Those falling under (i) are very common in Hong Kong.

- 2.3. In the event of a default by a mortgagor, the mortgagee will seek to enforce the security. With the introduction of the SSD the following problems are generated.

Legal Mortgage

- 2.4. A legal mortgage will contain a power of sale, or foreclosure, or right to appoint receiver that can be exercised by the mortgagee following a default situation.
- 2.5. There is uncertainty whether the exercise of any of such powers will constitute a "disposal" by the mortgagor under the amended SDO. If it does, then if a mortgagee sale or exercise of other mortgagee powers occurs within 24 months of the "acquisition" of the Property by the mortgagor, the mortgagee would in effect have to bear the liability of the proposed SSD. This may not occur in cases where the mortgagor refinances an earlier acquisition, but could occur where the loan secured by the mortgage was used to finance the mortgagor's acquisition of the property. The latter is extremely common in Hong Kong.
- 2.6. Under Section 50(2) of the Conveyancing and Property Ordinance, any receiver appointed will be deemed the agent of the mortgagor. The disposal of property by the receiver will therefore be deemed to be a disposal by the mortgagor. As for foreclosure, a "foreclosure order" is specifically included in the definition of "conveyance on sale" under section 2 of Stamp Duty Ordinance. As such, it appears that in the case of foreclosure by a bank :-



- (i) the mortgagor will be treated as having disposed of the property, and if the foreclosure is within 24 months of the acquisition of the property by the mortgagor, SSD will be payable; and
- (ii) the bank which forecloses will be treated as having acquired the property and will thereafter be caught by SSD again if it re-sells within 24 months after the foreclosure order (an act purely to recover repayment of a loan).

This does not seem fair as the mortgagee bank may only be obliged to foreclose (and not sell straightaway) due to bad economic condition.

As for the most usual kind of sale by mortgagee in possession (i.e. not through a receiver or pursuant to a foreclosure), the position is not clear whether SSD may be triggered where the mortgagee sale is within 24 months of the mortgagor's acquisition. The IRD's letter to the Law Society of 10 December 2010 on this issue (as posted on the Legco website and copy of which is attached) needs clarification on the different forms of enforcement.

- 2.7. If the liability of SSD is to be imposed on mortgagee banks, prudently, they will be obliged to take into account a liability of up to 15%, based on a pre-assessment of the value of the property upon enforcement within 2 years. Banks will therefore need to lower the lending level or otherwise bear the risk. If the bank is lending, for example, 70% of the value of the property, then it is taking the risk, in effect, on a loan of 85%. Alternatively, if the bank does not wish to take the risk by effectively lending at 85%, then it may be obliged to lend at 55% of the value of the property.
- 2.8. This in effect would affect real home-buyers who constitute the bulk of those customers who seek mortgage financing for completion of home purchases. The impact which SSD has on banks in assessing the loan amount could lead to such home buyers getting less loan that they hope to get. It also seems to be a measure against lending ratio which is in addition to the lower permitted lending ratio already introduced by Government to such speculation. We trust this is not what Government has in mind.
- 2.9. As regards application of sales proceeds upon a mortgagee sale, where there is negative equity, the mortgagee bank may not be able to recover its principal and interest if it has to bear the liability of SSD payable to the Stamp Office. It would then have to sue or even bankrupt the mortgagor for the shortfall, and in some cases, this may not be feasible if the mortgagor does not have other assets. Even where there is no negative equity, but there are multiple encumbrances, for example, where a mortgagee bank is the first mortgagee, followed by second mortgagee (usually a developer finance vehicle), the imposition of SSD would reduce any surplus sales proceeds which would otherwise be available to subsequent chargees and ultimately the home buyer mortgagor himself.



- 2.10. There may also be situations where a mortgage covers several properties, but sale pursuant to enforcement is one after the other under different transactions. The pre-assessment of the value of each of the mortgaged property for the purpose of determining the extra 15% liability for the bank (as mentioned in point 2.7 above) will be difficult.
- 2.11. All this does not appear to be the intended effect of the Bill and will prejudice and create unintended hardship for mortgagee banks/ financial institutions, not to mention adverse consequences for real home buyers.
- 2.12. It is noted that a sale or transfer of a property due to bankruptcy or involuntary winding up are proposed exemptions from SSD. It is logical that exemptions should also be granted to cases where a mortgagee exercises its power of sale or appoints a receiver to sell under a mortgage or forecloses on the property and then resells after foreclosure.

Equitable Mortgages

- 2.13. In addition to the remedies commonly available under a legal mortgage, an equitable mortgage as mentioned in paragraph 2.2(b)(i) above usually contains a power of sub-sale allowing the mortgagee bank to sub-sell the property even before the assignment of the unit is executed by the developer as vendor in favour of the mortgagor.
- 2.14. The same concerns that arise in relation to a legal mortgage apply equally to an equitable mortgage.

Recommendation

- 2.15. These effects appear to be beyond the intended scope of the Bill as the mortgagor/ mortgagee relationship does not fall within the scope of 'speculation'.
- 2.16. If the administration wishes to reduce the level of permitted lending on the security of a residential property then it should do so directly rather than through the oblique effect of SSD.
- 2.17. We recommend that an exemption be provided where a property is disposed further to a power provided under mortgage. Both (i) the vendor, and (ii) the purchaser should be exempted from SSD. This should include, inter alia, foreclosure, resale of property by a mortgagee after a foreclosure order is made, sale by mortgagee or sale by receiver appointed by mortgagee or sub-sale under an equitable mortgage. To ensure that this does not create an issue of avoidance, we recommend that the exemption only applies to the disposal where the mortgagee is a licensed bank or financial institution in Hong Kong and, possibly, also for a bona fide mortgagee for valuable consideration (collectively referred to as "**Exempted Persons**").



3. Additional SSD based on value of property at time of disposal

- 3.1. As SSD is based on the stated consideration for the sale or the market value of the property at the time of disposal as assessed by IRD, whichever is the higher, it is conceivable that the Stamp Office may, several months or even years later, demand *additional SSD* due to the inadequacy of the stated consideration. This could be relevant to a mortgagee bank at two levels -
- (a) the transaction between the vendor who sold to the mortgagor at the time of the mortgage ("the first level"); and
 - (b) also when and if the mortgagee bank exercises mortgagee sale within 24 months of the mortgagor's acquisition ("the second level"). At the second level, this can be a particular concern for mortgagee banks: whilst a mortgagee in enforcing security is by law obliged to fetch the best price reasonably obtainable to reduce a defaulting mortgagor's loss, in practice, it is common that a mortgagee bank has to dispose of the distressed property at a discount due to various factors such as the relatively poor state of the property repossessed, the psychological expectation of potential buyers that distressed properties are generally cheaper and/or the fact that the disposal takes place amidst a downward market.
- 3.2. Even if SSD based on stated consideration is paid by a mortgagee out of sales proceeds arising from a mortgagee sale, any surplus at the time will be either paid to subsequent chargees or released to the mortgagor. It is difficult, if not impossible, to trace the mortgagor, after the completion of the sale and purchase by the mortgagee bank, to make up the shortfall of any additional SSD.
- 3.3. In any event, as mentioned above for SSD generally, it is not appropriate for the mortgagee banks to be made liable for any additional SSD which may be assessed to be payable by the Stamp Offices on a vendor of the property. If for any reason, the IRD assesses a higher value and imposes additional SSD, it will be an unnecessary and unfair burden for banks.
- 3.4. Whilst we acknowledge that such possibility of reassessment has always existed under the current regime, the fact that there is a surcharge of up to 15% (which resulting amount can be substantial) and that the payment obligation is now on both parties to the transaction makes such possibility a real economic risk to the mortgagee banks.
- 3.5. We advocate that SSD should be payable solely by the vendor in the first level (i.e. excluding Exempted Persons) of the property. If this is not accepted, we advocate that any *additional SSD* due to any inadequacy of the stated consideration should be payable by the vendor in the first level (i.e. excluding Exempted Persons) alone, and that the liability of any *additional SSD* should not be attached as a liability on the property or affect the title generally or the interests of mortgagees or encumbrancers or a purchaser who purchases the property from such mortgagees or encumbrancers.



4. Confirmation of Good Title Before Drawdown of Mortgage

- 4.1. Hong Kong banks usually require a report of good title from its solicitor to be provided before they allow the drawdown of a mortgage loan by a mortgagor.
- 4.2. Under current practice, our understanding is that solicitors are able to issue "clean" report letters on title based on a pre-agreed arrangement whereby money for ad valorem stamp duty calculated based on the stated consideration is either set aside for stamping purpose after closing or there is appropriate solicitor undertaking to do the stamping. In other words, there is certainty that upon presenting the calculated amount to the Stamp Office, the chop "stamp duty paid" will be endorsed on the Assignment, and this will be sufficient to allow the Assignment to be registered at the Land Registry in order to preserve the priority and interest of the mortgagee bank.
- 4.3. With the imposition of SSD, being a substantially greater amount of up to 15% of the value of the property, mortgagee banks may receive objections from solicitors to issue "clean" report letters, or otherwise be forced to accept "qualified" report letters before drawdown. This is because (a) even if sufficient moneys for SSD payable by the vendor of the property (who is selling to the mortgagor) based on stated consideration is set aside for payment, additional stamp duty may be assessed by the Stamp Office (refer to point 3 above), so it is doubtful whether the report to bank can state that "all stamp duty has been paid", or whether title is "clean" prior to the final assessment by the Stamp Office, and (b) the report sometimes may need to state that no tax or payment is required prior to any enforcement by the mortgagee bank: a qualification may be needed in that SSD may be payable upon mortgagee enforcement (if within 2 years of the acquisition of the property by the mortgagor), or where additional SSD is subsequently assessed to be payable by the vendor of the property on the prior sale transaction. As a result, there will be extra administrative work for banks, and also create unnecessary complications prior to drawdowns.
- 4.4. We comment that unless Exemption Persons are exempted from payment of SSD (as mentioned in paragraph 2.17 above) and *additional* SSD (as mentioned in paragraph 3.5 above), the mortgagee banks and financial institutions will be affected by these administrative problems.

5. Retrospective Effect of the Bill

- 5.1. We oppose the inclusion of clause 1(2) of the Bill which provides for retrospective effect from 20 November 2010.
- 5.2. The Bill was published in the Gazette on 3 December 2010. It does not seem reasonable to expect compliance with the provisions of a Bill prior to it becoming available to the public. Even from 3 December 2010, compliance with the Bill (which may change as part of the legislative process) would not necessarily guarantee compliance with the law following amendment.



5.3. Retrospective law should be an exceptional measure, only put in place in exceptional circumstances. We appreciate that the administration wishes to take decisive action against speculators. However, the legislature has not provided the relevant government departments with a power to make law. To permit the bill to be retrospective from the date of an announcement is tantamount to conferring a power to make law through administrative decision.

5.4. We advocate the removal of clause 1(2) of the Bill.

6. Adjudication

6.1. To reduce uncertainties imposed by SSD, we advocate a new adjudication procedure to allow an instrument to be adjudicated for the amount of stamp duty payable, or to ascertain whether SSD is payable in advance of a proposed transaction, prior to an instrument being executed.

6.2. Unless Exemption Persons are exempted from SSD and *additional* SSD as mentioned above, we would advocate this be introduced by broadening section 13 of the SDO.

7. Clarifications

7.1. In our view the Bill's drafting could be improved by:-

- (a) providing a more detailed definition of when property is "acquired" and "disposed of"; and
- (b) providing for a consistent and more detailed definition of "equitable interest", as there are varying definitions of this in the SDO, as well as in the Conveyancing and Property Ordinance.

7.2. We advocate amendments to the Bill to provide for these clarifications.

8. Summary of Our Recommendations

8.1. We advocate the following amendments to the current draft:-

- (a) an exemption for properties disposed of upon enforcement of mortgages (both legal and equitable), whether with or without assistance of the courts and/or the cooperation of the relevant mortgagor, by licensed banks and financial institutions in Hong Kong, and also for a *bona fide* mortgagee for valuable consideration and also on resale after a foreclosure order is made;



- (b) to eliminate or reduce the impact of the issues identified in points 3 and 4 above, SSD should be made payable solely by a vendor (excluding Exempted Persons) of the property; if this is not accepted, then at least *additional* SSD should be made payable solely by the vendor (excluding Exempted Persons) and should not be attached as a liability on the property or affect the title generally or the interests of mortgagees or encumbrancers or a purchaser who purchases the property from such mortgagees or encumbrancers;
- (c) removal of clause 1(2) of the Bill providing for the retrospective effect of the Bill;
- (d) introducing an adjudication mechanism for the amount of stamp duty payable, or ascertain whether SSD is payable in advance of a proposed transaction, before an instrument is executed; and
- (e) making drafting changes and providing clarification on the following points:-
 - i. when a property is “acquired” and “disposed of”; and
 - ii. providing a consistent and more detailed definition of “equitable interest”.

We thank this honourable Committee in advance for its consideration. For any questions, please do not hesitate to contact our Senior Manager, Ms Grace Law, at 2521 1880.

Yours faithfully

Eva Wong
Secretary