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

Responses to follow-up actions arising from the discussions at the meetings on 17 and 21 December 2010 (Part II)

Introduction

At the meetings of the Bills Committee on the Stamp Duty (Amendment) (No.2) Bill 2010 (the Bills Committee) held on 17 December 2010 and 21 December 2010 respectively, Members raised a number of questions relating to the scope, operation and legal aspects of the proposed Special Stamp Duty (SSD). We provided responses to some of the questions on 4 January 2011. We now provide the Administration's consolidated response to the remaining questions, with input from the Transport and Housing Bureau (THB), the Financial Services and Treasury Bureau, the Inland Revenue Department (IRD) and the Department of Justice (DoJ).

(a) Clarifications of the terms "acquire" and "dispose of" and the application of SSD in various situations

2. Since the announcement of the introduction of the SSD on 19 November 2010, we have received various comments and enquiries from Members, deputations, professional and related trade associations, and the public on the terms "acquire" and "dispose of" in the context of the Bill. The Administration will address these concerns by proposing Committee Stage Amendments (CSAs). We intend to submit the draft CSAs to the Bills Committee for consideration at its next meeting on 9 February 2011.

(b) To advise the circumstances/consequences if the commencement date in clause 1(2) is repealed or amended

3. There is a need to send a clear message to the market to deter speculative activities, and to avoid inadvertently creating a situation whereby people are encouraged to speculate during the period prior to the enactment of the legislation. The Financial Secretary made public on 19 November 2010 that the SSD will come into effect on 20 November 2010, subject to the passage of the Stamp Duty (Amendment) (No. 2) Bill 2010 (the Bill) which will take effect retrospectively from 20 November 2010. The public is well aware of the effective date of the SSD as announced, and buyers and sellers have already taken into account the SSD when considering flat sale/purchase or otherwise on or after 20 November 2011. Repealing or amending the

commencement date will only cause confusion and undermine the clear message of the Government's determination to curb speculation.

(c) To consider expanding the exceptions for SSD to include financial hardship and substantial changes of circumstances, as well as providing an appeal mechanism on SSD. To also advise whether similar relief had been provided for the obsolete estate duty or in current tax legislation

4. The Bill has proposed exemptions from payment of the SSD under various circumstances, including sale or transfer of residential properties due to bankruptcy or company winding up by the court on the ground of inability to pay debts. The law needs to be clear and precise. To provide exemptions to cater for individual circumstances such as financial hardship will compromise the effectiveness of the SSD.

5. The Inland Revenue Ordinance (IRO), the Stamp Duty Ordinance (SDO) and the Estate Duty Ordinance (EDO) do not have any provision allowing the Commissioner of Inland Revenue to waive tax/duty on the ground of financial hardship or changes of circumstances of the taxpayers/duty payers. To provide exemptions from the payment of SSD for financial hardship and changes of personal circumstances will be a fundamental deviation from the present taxation system.

(d) To advise (with illustrations) the existing revenue ordinances which have retrospective effect

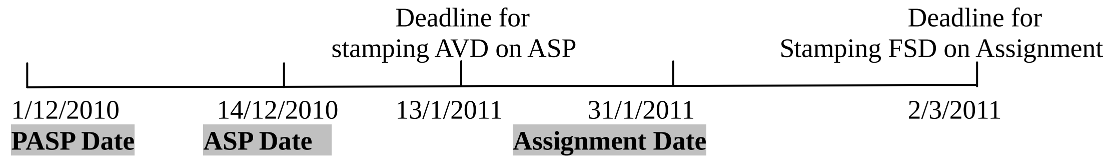
6. The following legislations were passed with retrospective effect:

Legislation	Section amended	Date of announcement	Commencement date	Enactment date
Inland Revenue (Amendment) Ordinance 1987	15A	25 February 1987	26 February 1987	29 May 1987
Inland Revenue (Amendment) Ordinance 1992	16E	17 April 1991	18 April 1991	13 March 1992
	22B	14 November 1990	15 November 1990	13 March 1992
	39E	14 November 1990	15 November 1990	13 March 1992

(e) To provide a flowchart on the application of stamp duty in respect of property transactions

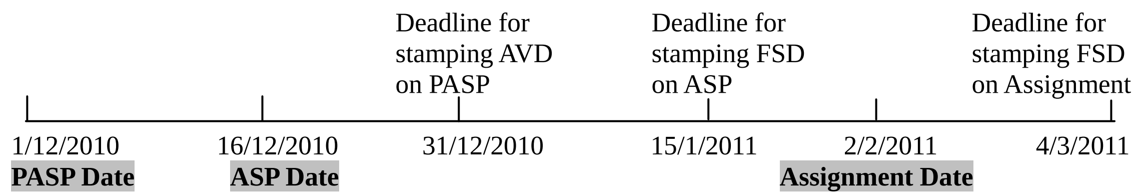
7. Time for stamping a Provisional Agreement for Sale and Purchase (PASP), an Agreement for Sale and Purchase (ASP) or an Assignment involves Ad Valorem Duty (AVD) and Fixed Stamp Duty (FSD) of $100 are as follow –

(i) If ASP is executed within 14 days from the date of the PASP



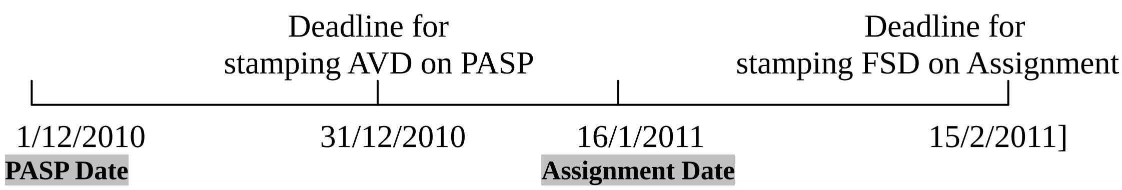
If the ASP is executed within 14 days from the date of the PASP, the PASP will cease to be chargeable to any stamp duty. The time for stamping the ASP with AVD is within 30 days from the date of its execution. If the ASP date is on 14/12/2010, the deadline for stamping AVD on ASP will be on 13/1/2011. We picked a date as the Assignment Date for illustration purpose only. If the Assignment Date is on 31/1/2011, the time for stamping the assignment with FSD is within 30 days from the date of its execution (i.e. 2/3/2011).

(ii) If ASP is not executed within 14 days from the date of the PASP



If the ASP is not executed within 14 days from the date of the PASP, the PASP will continue to be chargeable with AVD and the deadline for stamping the PASP is 30 days from 1/12/2010 (i.e. 31/12/2010). The ASP is chargeable with FSD of $100 and the time for stamping the ASP is within 30 days after the date of the ASP (i.e. 15/1/2011). We picked a date as the Assignment Date for illustration purpose only. If the Assignment Date is on 2/2/2011, the time for stamping the assignment with FSD is within 30 days from the date of its execution (i.e. 4/3/2011).

(iii) If no ASP is executed after signing the PASP



If ASP is not executed, the PASP will be chargeable with AVD and the deadline for stamping the PASP is 30 days from 1/12/2010 (i.e. 31/12/2010). We picked a date as the Assignment Date for illustration purpose only. If the Assignment Date is on 16/1/2011, the time for stamping the assignment with FSD is within 30 days from the date of its execution (i.e. 15/2/2011).

(f) To advise whether it is a usual practice for an Agreement for Sale and Purchase to be completed 14 days after the signing of PASP. If so, the application of SSD to PASP signed 14 days before the announcement of SSD on 19 November 2010

8. Note 2 to Head 1(1A) in the First Schedule of the SDO stipulates that if, within 14 days of the time due for stamping, an agreement for sale (usually a PASP) is superseded by another agreement for sale (i.e. an ASP) made between the same parties and on the same terms, the time for stamping the second agreement (i.e. an ASP) with the AVD will be 30 days from the date of its execution. If the ASP is not executed within 14 days from the PASP, the PASP will continue to be chargeable with AVD and the deadline for stamping the PASP will be 30 days from the date of its execution. To get the benefit of an extended period for stamping the AVD as mentioned, the Stamp Office understands that it is a common practice of the market to execute an ASP within 14 days from the signing of the PASP.

9. On the latter part of the question, please see paragraph 2 above.

(g) To compare the effectiveness of SSD and punitive profits tax (say 90%) in curbing property speculation while minimizing the impact on genuine home buyers

10. The 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. Also, profits tax is levied on the net profits (after taking into account losses, if any) accrued to an individual or company on the basis of the year of assessment. The Administration considers that the SSD, as compared with "profits tax", is a more targeted and effective measure to curb short-term speculation.

11. We set out at the **Annex** some examples to illustrate the calculation method, payment period and the amount of tax payable in terms of the SSD and a profits tax at 90%.

(h) To also advise whether the anti-tax evasion measures under the existing tax legislation can be invoked if the setting up of shell companies was to evade SSD. To consider the feasibility of applying SSD to property transactions through transfer of shares of companies

12. Stamp duty on transfer of immovable properties and transfer of shares are charged under different heads in the SDO. The former is charged under Head 1 of the First Schedule and the latter is charged under Head 2 of the First Schedule. As explained in our reply of 4 January 2011, IRD has been actively tracking and taking follow-up actions on property speculation cases, including cases involving shares transfer 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.

13. Since April 2010, the Stamp Office has compiled statistics on those suspected speculation cases in the form of shares transfer of "property holding companies" and which the Stamp Office has referred to the Assessing Unit for follow-up actions. IRD will continue to collate the aforementioned statistics to keep track of the situation.

(i) The application of SSD in respect of compulsory sale of developments

14. A sale of residential property carried out pursuant to an order for sale made by the Lands Tribunal under the Land (Compulsory Sale for Redevelopment) Ordinance (Cap 545) is subject to AVD. SSD may apply if an owner sells the property under the aforementioned order for sale in less than 24 months after acquiring the property. That said, the Lands Tribunal may under section 4(6)(a)(i) of Cap 545 give directions relating to the sale and purchase of the lot including settling the particulars and conditions of the sale of the lot. In this respect, the Lands Tribunal may direct a contractual party to pay stamp duty and/or SSD, notwithstanding the amendments proposed to the SDO for the introduction of the SSD.

(j) The application of SSD in respect of mortgaged properties, including those subject to foreclosure orders

15. As advised in paragraph 2, the Administration will submit CSAs to clarify the application of SSD in various situations. The Administration will respond further upon submission of the CSAs.

(k) To provide a written response to LC Paper No. CB(1) 822/10-11(03), particularly on the question of conformity with the Basic Law if SSD amounts to a partial confiscation of the value of property sold within 24 months

16. In the written representation as set out in LC Paper No. CB(1) 822/10-11(03), it is alleged that SSD is not a form of legitimate taxation since: (a) it amounts to a partial confiscation of the value of property as its rate may be as high as 19.25%; and (b) it restricts the right to the disposal of property under Basic Law (BL) 105 by imposing a penalty for disposing of a property within the first two years of ownership.

17. We consider the first argument doubtful in the light of the Court of Appeal's decision in Weson Investment Ltd v Commissioner of Inland Revenue (2007) that legitimate taxation is governed by BL 108 (not BL 105) and is not subject to an overriding requirement of proportionality stemming from BL 105. Even if taxation were subject to such an overriding requirement of proportionality, the collection of SSD is likely to be a proportionate measure in view of the case law developed under Article 1 of Protocol No 1 of the European Convention on Human Rights. Under such case law, states have been given a very considerable margin of appreciation in taxation matters and the court will not intervene unless the legislation amounts to an "arbitrary confiscation" or is "devoid of reasonable foundation".

18. As regards the second argument, a tax can be used to regulate or control behaviour in the same way as regulatory laws backed up by the threat of a fine. Further, as the liability to pay the SSD does not arise from any failure to discharge any antecedent obligations in law, the SSD should not be considered as a fine. It is also said that SSD amounts to a penalty because it bears no relation to profit or loss and is imposed in addition to profits tax. Yet, the above have always been the features of stamp duty which has been collected in Hong Kong as early as 1860s. Given the theme of continuity in the BL, it can hardly be doubted that the SSD, being a species of stamp duty, is a form of legitimate taxation permissible under the BL despite its above features.

19. In sum, the arguments in the LC Paper that the SSD is not a form of legitimate taxation but instead amounts to a confiscation of property or a penalty are not tenable. As a form of legitimate taxation, it is to be governed by BL 108 (but not by BL 105). We consider the SSD to be a proportionate measure, and will not adversely affect any property rights protected under BL 105.

20. For the other comments raised in the LC paper, the Administration will provide responses to them together with the Administration's responses to other written representations in one go.

Transport and Housing Bureau
Financial Services and Treasury Bureau
Inland Revenue Department
Department of Justice
January 2011

Annex

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%

<table>
<tr><th>Individual</th><th>Sole Proprietorship</th><th>Company</th></tr>
<tr><td colspan="2">● 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.</td><td>● 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.</td></tr>
<tr><td colspan="3">Special Stamp Duty (SSD)
● 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</td></tr>
<tr><td colspan="2">Profits Tax
● 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
(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.)
● Date of Profits Tax Assessment: 20 October 2011
● Due date for payment of profits tax: 6 December 2011</td><td>Profits Tax
● 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
(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.)
● Date of Profits Tax Assessment: 20 November 2011
● Due date for payment of profits tax: 2 January 2012</td></tr>
<tr><td colspan="3">Calculation of Assessable Profits:
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</td></tr>
</table>

<table>
<tr><td colspan="3">Calculation of Tax Liability:</td></tr>
<tr>
<td>If Mr. A elects Personal Assessment (PA), the tax liability will be as follows:
Assessable profits 1,385,000
<u>Less</u>: Basic allowance (assuming he is single) 108,000
Net chargeable income $1,277,000

PA Tax thereon $205,090</td>
<td>Profits Tax liability ($1,385,000 x 90%) $1,246,500

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)</td>
<td>Profits Tax liability ($1,385,000 x 90%) $1,246,500

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-

Profits on disposal 1,385,000
<u>Less</u>: 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</td>
</tr>
</table>

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.)