

BSD and SSD 2.0
Submission to Legislative Council Bills Committee
on Stamp Duty (Amendment) Bill 2012
5th February 2013

Dear Members of the Committee,

Thank you for your invitation to submit views on the Stamp Duty (Amendment) Bill 2012 (the **Bill**), which proposes (backdated to 27-Oct-2012):

- for Special Stamp Duty (**SSD**) on the resale of residential property within a certain period after purchase, to expand the scope from 2 years to 3 years, and to increase the rates from 15% to 20% of value in the first 6 months, from 10% to 15% in the second 6 months, and from 5% to 10% in the 2nd and 3rd year; and
- to introduce Buyer's Stamp Duty (**BSD**) on residential property, in addition to regular stamp duty, unless the buyer is a [permanent resident \(PR\)](#) of HK.

I have read the [Legislative Council Brief](#), as well as the earlier brief by Government of October 2012, "[Further Measures to Address the Overheated Property Market](#)".

Stamp duty is an antiquated and inefficient tax

Regular stamp duty is an antiquated and economically inefficient tax, introduced into Britain in 1694 by King William III of Orange and Queen Mary II, to finance a war with France. It taxes not the generation of economic gain, as salaries tax and profits tax do, but instead taxes the mere transfer of certain types of assets, thereby adding friction to the wheels of the economy. In real estate, it distorts the choice between owning and renting homes, offices and shops, and provides a disincentive to relocation, often being equivalent (at [current rates](#)) to over 1 year's rent. In the markets, it distorts the choice between shares (where transfers are taxed) and derivatives (where they are not). So if the purpose of stamp duty is to stifle speculation, then in the stock market, it does the opposite, driving people into warrants, options and other derivatives.

The only merit of regular stamp duty is that it raises revenue, but it is better to do that by taxing GDP via salaries tax and profits tax, and not taxing asset transfers, as these do not, of themselves, generate GDP. Regular stamp duty is also easily avoided with corporate tax planning, so transfers of ultimate ownership of larger properties such as hotels, office blocks, and increasingly, higher-value homes, often take place by transfers of holding companies instead.

SSD is unconstitutional

Special Stamp Duty, as enacted in HK in 2011 (backdated to 20-Nov-2010), penalises an owner for re-selling his property within a fixed period of time, by seizing a portion of the proceeds. A person who sells after the time has elapsed suffers no such impact. We again submit, [as we said then](#), that SSD is unconstitutional. The HKSAR has the power of taxation under [Article 108 of the Basic Law \(BL 108\)](#), but that power is not unfettered - it only applies to legitimate taxation, the purpose of which is to raise revenue, either for general purposes or to offset a related cost born by society as a whole. You can't just invent a penalty and call it "taxation", otherwise any behaviour, even if not harmful, could be penalised through taxation, rather than through the due process of the criminal law.

Tobacco duty, for example, is a legitimate tax because of the healthcare costs of smoking borne by the Government through the public health system, the lost taxes from premature retirement and death, and the welfare costs for surviving dependents. If smoking was not harmful to health, tobacco duty would have no legitimate purpose - it would be overly narrow, singling out one consumer product over others. In another example, fuel duty is a legitimate tax because of the costs of building and maintaining the roads (including the opportunity cost of the land they occupy) and the health costs from vehicular air pollution.

The purpose of SSD was not to raise general revenue - in fact it reduces revenue, by inhibiting transactions and hence reducing regular stamp duty. The admitted purpose of SSD was to target an alleged harm to the public interest, namely "speculation". Yet the Government has not provided a shred of evidence, either qualitative or quantitative, that "speculation" causes costs to society that should be recovered through taxation. If anything, the evidence points to the contrary - HK was built on risk-taking entrepreneurialism. When a person buys old apartments for renovation and resale, he upgrades the quality of HK's housing stock, and pays profits tax on his profits. Both are social goods. That renovation industry, which also generated employment, has been heavily impacted by SSD, and will be further harmed by its expansion and by BSD (see below).

[Article 105 of the Basic Law \(BL 105\)](#) protects property rights, an essential element of a free market and capitalist system, which [Article 5 of the Basic Law](#) promised "shall remain unchanged for 50 years". You only really own an asset if you are free to dispose of it to whomever you like without penalty, so BL 105 says that the HKSAR:

"shall, in accordance with law, protect the right of individuals and legal persons to the acquisition, use, disposal and inheritance of property".

Implicitly, there should be no penalty for exercising that right, just as there cannot be a levy on free speech ([Article 27](#)) or religious affiliation (Article 32). So a specific tax on the sale of newspapers, Bibles or Korans would be unconstitutional. In essence, you can't establish a right in a constitution and then remove or inhibit it through penalties. In its [own paper](#) (page 4, para. 9), the Government admits that SSD is a "penalty".

So if a levy on the early resale of real estate is not a legitimate tax, then it is a penalty and falls outside the provisions of Article 108 and is implicitly prohibited by Article 105.

SSD is too wide - exempt genuine homeowners

SSD contains no exemption for owner-occupiers of their own homes, who might simply need to upgrade (due to family enlargement) or downgrade (due to financial circumstances, or to take out equity after an increase in prices) or sell due to job relocation. By extending SSD to 3 years, the Government will capture even more unintended victims. If your wage-earning spouse dies in an accident just after you have bought a home, and you can't afford to pay the mortgage, you now have a choice between losing 20% of its value (and possibly all of your equity) to SSD, or waiting for the bank to declare you in default and foreclose. If your employer asks you to relocate to the mainland soon after you have bought a home, you have a choice between losing 20% of its value to SSD, or having to lease out the home or leave it empty until the 3 years are expired. And if you bought after SSD was introduced and can't believe how much your home value has increased since then, you can't diversify your risk until the time expires. In essence, the Government has locked you in to your own home.

So even if you accept that property speculation is harmful to society, then you must ask whether SSD is accurately focussed, and whether it causes more collateral damage to unintended victims than it purports to fix. **We submit that there should be an SSD exemption if at some point in the 365 days before the transaction, the vendor owned only one residential property and at all times in the period he did not own more than two.** This would indicate that the vendor is selling his current or recent home. He might have already acquired a new home and therefore temporarily own two, with one to be sold. It would be easy to verify how many he owned at all times using data in the Land Registry. Exempting home-owners would free them to make choices based on their personal circumstances, not on whether they will incur SSD if they move. It would focus SSD more on the alleged speculative behaviour, and stop the dragnet approach.

The same exemption should be introduced for regular stamp duty for anyone who has no existing property, or is moving from one home to another. Why, if the government wants to improve affordability, does it slap up to 4.25% stamp duty on homes? It then makes mortgage interest tax-deductible, up to \$100,000 per year for 15 years, and in his [manifesto](#) (page 36, para 5), the Chief Executive said he would raise this to \$150,000 per year for 20 years. At the highest [marginal tax rate](#) of 17%, this is worth $17\% \times \$150,000 \times 20 = \$510,000$ over 20 years. Assuming a 3% discount rate, that has a net present value of about \$379,000, equivalent to the 3.75% stamp duty on a home worth \$10.1m. So the Government takes with one hand and returns, slowly, with the other, but only if you have a mortgage and a high enough income, and only if you don't move homes after the first purchase (or you will be paying N times stamp duty). **Surely it would be fairer to abolish both stamp duty and mortgage interest deduction.**

Now we turn to BSD.

BSD is unconstitutional

Again, like SSD, BSD is not intended as a revenue-raising measure, but to target a specific group of purchasers, being everyone other than PRs, thereby favouring PRs. As noted above, BL 105 protects the rights of "individuals and legal persons" to the acquisition of property, including real estate. "Individuals" of course includes all humans, not just PRs, and "legal persons" includes companies. A discriminatory duty on non-PRs is implicitly unfair to them, and implies that the "rights of individuals and legal persons" are different depending on their immigration status and legal form. **We do not think that the drafters of the Basic Law intended to allow different property rights for different people. The rights should be equal.**

It would be one thing to add 15% duty to all purchases by all buyers for the purpose of raising revenue under BL 108, but that is not the purpose of BSD. **We submit that BSD falls outside BL 108 and is prohibited by the rights protected under BL 105.**

BSD is discriminatory

BSD is a discriminatory measure. It tells non-permanent residents, and prospective talented immigrants, that if they move to HK, they won't be able to buy a home for 7 years until they have become a permanent resident, unless they pay a 15% surcharge designed to deter them. It also imposes a surcharge on companies and other organisations that might want to buy staff quarters, placing them at a competitive disadvantage to well-established employers who already own staff-quarters. **We submit that if BSD proceeds, then all residents with ID cards, PR or not, and all companies with business registrations in HK should be exempt.** That would still leave a discriminatory law, but it would discriminate between non-residents and residents and allow companies with business registrations to do business, rather than the narrow PR-only approach.

In some ways, BSD will harm the very people it is intended to protect, by ensuring that more properties will be owned by PRs when the bubble bursts than if non-PR buyers were allowed to purchase. It is a message to non-PRs: "keep out, we're having a party here, and you don't want to get our hangover". Perhaps the message should be "BSD - Hong Kong hangovers for Hong Kong People".

Even if you accept that BSD is somehow protecting the market for PRs, rather than sucking them into the bubble, do we really need to charge it on high-value properties, which are not by any stretch of the imagination aimed at first-time buyers struggling to get onto the property ladder? What exactly is the purpose of that - is it a right of permanent residents to be able to buy a HK\$50m flat, ahead of non-permanent residents? Or should we only charge BSD on homes below a certain price, thereby pushing non-PRs to buy high-end properties and leave the mass market for PRs?

Serviced apartments

BSD also prohibits investors from collaborating via companies to acquire, renovate and rent out apartments as a business. This will also heavily impact owner-operators of serviced apartments, who cannot acquire and rent out properties without paying BSD. **We submit that if BSD proceeds and there is no exemption for local businesses, then there should at least be an exemption for the purchase of an entire multiple-dwelling building.**

Renovation industry

BSD also prohibits companies and non-PRs from upgrading the housing stock by acquiring, renovating and selling old apartments. Not only will they pay 10-20% SSD on a resale, but they will also have to pay 15% on the purchase, a total of 25-35%, plus regular stamp duty on the purchase. Prohibiting this industry is surely not in the public interest. Such apartments are their inventory, and they would pay profits tax on the sale (if a profit was made). BSD and the extension of SSD basically eliminate that sector.

Redevelopment industry

Under the [Land \(Compulsory Sale for Redevelopment\) Ordinance \(LCSRO\)](#), redevelopments of old buildings have often accomplished by assembling fractional ownership by gradual acquisition of units. A developer can acquire 80% or 90% ([depending](#) on the age, type and number) of the units, and then apply to trigger an auction of the entire site, which he may or may not win, but whoever wins will produce new property to supply the market.

The draft Bill includes a BSD refund scheme if a person redevelops a site within 6 years of completing the acquisition, but this is of no value if the person who triggers the auction does not win the auction. He will have paid BSD up front for at least 80% of the units and will never get it back, as he loses the site. Meanwhile the auction winner pays BSD itself, redevelops the site, and reclaims the BSD. In framing the rebate scheme, the Government makes an amazing presumption that only the person who triggers the auction will win it - which rather suggests that they don't expect the LCSRO to produce fair and open auctions.

Therefore, the proposed refund scheme does not work. No potential developer will set out to acquire units of a fragmented ownership, paying 15% BSD on each purchase, if they cannot be sure of getting it back. They might not even get to the 80% or 90% threshold, and the result would be that they own a bunch of expensively-acquired old apartments and never get the BSD back.

In short, BSD kills off the private redevelopment sector. That leaves the [Urban Renewal Authority \(URA\)](#), a Government entity, to monopolise the redevelopment market, increasing Government intervention in the sector. The URA is insensitive to price (it pays the value of a 7-year-old flat, not a 50-year-old-flat, so that's well above market value), and any stamp duty it pays goes back to its owner, the Government.

In truth, once the LCSRO was passed, the URA, with its statutory powers of compulsory purchase, was

redundant, because the private sector was then able to overcome the "last man standing" problem and proceed with redevelopments. The private redevelopment market was beginning to function, but the Government is taking that away with BSD and handing it back to the URA. The Government should abolish the URA and allow the private sector to function.

Under Schedule 3 of the LCSRO, the winner is obliged to redevelop the site within 6 years, so we see no point in requiring them to pay BSD either, because they will certainly get it back when the development completes, so it would just amount to an interest-free loan to the Government from the winning bidder, increasing the capital cost of redevelopment. This is a "single lot" purchase. We submit that **if BSD proceeds, then winners of auctions under the LCSRO should be exempt**, because they are contributing to the supply of new units and would get it back anyway. Even then, such auctions are only likely to be triggered when existing owners get together, rather than by risk-taking developers who would have to pay BSD without any certainty that they will reach the threshold for redevelopment.

Such an exemption would also put auctions of sites under the LCSRO on a level playing field with auctions and tenders of Government land (involving new leases), where no BSD is payable. Otherwise, **BSD tilts the playing field away from redevelopment in favour of new land leases from the Government**. In short, the Government is favouring its own land sales over private sector land from the LCSRO process. That is against the public interest, which calls for using existing sites to their full potential before consuming undeveloped land.

Companies

We agree with the Government that it would be impossible to devise a scheme which exempts companies owned by permanent residents (**PRs**) from BSD without creating loopholes. A company could be beneficially owned by a permanent resident today, but under a forward sale agreement, or with a put-option and call-option at the same exercise price over the shares, it could in effect be pre-sold to a foreign buyer, to be completed when the tax is abolished. Companies can also start out with 1 share owned by a permanent resident, buy the property, and then issue 999 shares to a non-PR, thereby effecting a change of 99.9% ownership. The remaining share could be converted into a deferred share with near-zero economic rights, making it 100% owned by the non-PR.

Of course, before the Government announced BSD, many of the higher-value properties were already owned by companies. I purchased my home through an offshore company in 2006 (paying 3.75% stamp duty at the time, or about 1 year's rent), and if I ever want to sell the company then I will be free to sell it to anyone I want, without either side paying stamp duty or BSD. The same is true for owners of whole residential buildings via companies. The buyer takes a risk of hidden liabilities in the company, but when the alternative is paying 19.25% in stamp duty (including the 4.25% regular duty) then it is a risk worth taking in most cases, particularly where there is a credible vendor and a warranty is given.

In the time between the first SSD announced on 19-Nov-2010 and the BSD announcement on 26-Oct-2012, we would expect that a higher proportion of property purchases have been structured via offshore companies, to provide that flexibility and avoid any risk of SSD. The apparent effect of the BSD and SSD announcements on transaction volumes is at least partly offset by the invisible transactions involving the sale of offshore companies which own property either directly or through a HK-incorporated subsidiary.

Non-local buyers were already declining before BSD

An inconvenient truth, from the Government's perspective, is on page 5 of the [briefing paper](#) to LegCo dated October 2012. This reveals that "non-local buyers" as a percentage of residential transactions were 4.5% in 2010, 6.5% in 2011 and **back down to 4.5% in the first 9 months of 2012, before BSD was announced**. This is what the Government called a "general uptrend". It is nothing of the sort, merely an increase followed by an identical decrease. The slowdown of the mainland economy in 2012, the tightening of mortgage loan ratios, and the elevated prices were already lessening the demand. Even so, 95.5% of transactions in the first 9 months of 2012 were implicitly with local buyers.

The current Chief Executive, who is himself a real estate expert, was quoted in a [Government press release](#) on 19-Jun-2012:

"He said that although non-Hong Kong residents are still coming to the city to purchase properties, they are not doing so in numbers that affect resident Hong Kong buyers."

So why impose BSD then, and why target residents who are not PRs? Either his expert view 11 days before he took office has changed, or BSD is purely a populist move which contradicts his expert view.

Decision without proper basis

On 1-Nov-2012 we asked the Government by e-mail what they meant by "non-local" buyers in their statistical analysis. The spokesman's response on 6-Nov-2012 was:

"Individuals with no Hong Kong Identity Card number and companies which are not registered under the Business Registration Ordinance (Cap 310) were taken as non-local buyers... The statistics therein were compiled basing on the information provided in the stamping requests received by Stamp Office."

So "local buyers" does include residents with non-permanent ID cards. But the BSD proposal discriminates between residents who are permanent and non-permanent (not yet here for 7 years). The Government has said that it intends to prioritise those residents who have "made a commitment" to HK. What could be a greater commitment than buying a home, and paying the regular stamp duty which is equivalent to a year's rent? Surely anyone who does that doesn't plan on leaving soon. Does it really matter if you haven't been here 7 years?

For what it is worth, we asked the Government whether they had even bothered to determine, by matching buyer's ID numbers with the immigration department's database, what proportion of the ID card holders were PRs and not PRs. It would have been a relatively simple exercise, particularly on a sample basis rather than examining all transactions, and you would think that this data was available before they decided to exempt only PRs and charge other residents. The spokesman's answer on 14-Nov-2012:

"The Government has not conducted a matching of the records between the government departments for the purpose of deriving the number of residential properties purchased by permanent residents of Hong Kong."

So they don't actually know how many buyers were PRs, and how many were residents but not PRs.

It is quite clear that this discriminatory policy was launched without even having supporting data. It is a policy without foundation, unless you count pandering to xenophobic sentiment as a sound basis for policy-making. Keep in mind that many of the non-permanent residents today will be permanent residents with votes in 2016 and 2017. They will remember this policy.

I shall be pleased to attend the Bills Committee meeting at 09:00 on 18-Feb-2013, and in the meantime I am happy to discuss this with any of you separately.

David Webb
Founder, Webb-site.com

© Webb-site.com, 2013