

**The Administration's response
to the issues raised at the meeting
of the Bills Committee on the Stamp Duty (Amendment) Bill 2012
held on 20 May 2013
and
the submission from the Law Society of Hong Kong of 28 May 2013**

This paper sets out responses to the issues raised in the letter from the Legislative Council Secretariat of 21 May 2013 (LC Paper No. CB(1)1218/12-13(01) refers), as well as the submission from the Law Society of Hong Kong (the Law Society) of 28 May 2013 (LC Paper No. CB(1)1165/12-13(01) refers).

Issues in relation to LC Paper No. CB(1)893/12-13/(02)

2. The Administration has further considered the outstanding issues mentioned in LC Paper No. CB(1)893/12-13/(02), as well as Members' views raised at the Bills Committee meeting on 20 May 2013. The Administration's response to the relevant issues is set out below.

Items 16 and 27 of LC Paper No. CB(1)893/12-13/(02)

3. To forestall hardship created for a non-Hong Kong permanent resident (non-HKPR) property owner who may have been made to sell his or her residential property not of his/her own volition, as in the case of acquisitions by the Urban Renewal Authority, resumption by the Government under the Lands Resumption Ordinance (Cap.124), or pursuant to an order for sale made under the Land (Compulsory Sale for Redevelopment) Ordinance (Cap.545), we have proposed in the Stamp Duty (Amendment) Bill 2012 (the Bill) that the replacement purchase made by a non-HKPR property owner who is affected under any of the above three scenarios will be exempted from the BSD. If the property to be replaced is jointly owned by two or more persons, each of them may make one replacement purchase and both transactions will be exempted from the BSD.

4. The Law Society and the Hong Kong Conveyancing & Property Law Association Limited have earlier suggested that the list of scenarios mentioned in paragraph 3 above is not exhaustive, and that the exemption should be extended to cover other similar scenarios. We have studied

their proposals very carefully and agree that some of the suggested scenarios involve similar resumption of land not of the land owner's volition and that BSD exemption should be offered for replacement purchases thus made. In considering the proposals of the two organisations, we have also identified other similar scenarios. Details of all these additional scenarios are at **Annex I**. We propose that replacement purchases made by a non-HKPR property owner (or owners) affected under the scenarios listed in Annex I should also be exempted from the BSD. We will introduce committee stage amendments to the Bill accordingly.

Items 19 and 38 of LC Paper No. CB(1)893/12-13/(02)

5. At present, section 15 of the Stamp Duty Ordinance (Cap.117) provides that instruments not duly stamped are not admissible in proceedings other than criminal proceedings and civil proceedings initiated by the Inland Revenue Department (IRD) to recover stamp duty and penalty. The Law Society and the Hong Kong Association of Banks consider that it should be the property buyer's liability to pay the BSD, and that any failure to pay the BSD by such a buyer should not affect the innocent seller's right to present the relevant documentation in certain court proceedings for purposes including to prove his / her title to the property. The Administration agrees to the suggestion, and proposes that an instrument that is chargeable with the BSD but has not been duly stamped may still be received in evidence in civil proceedings before a court, provided that –

- (a) the instrument is not duly stamped only in relation to the BSD chargeable on the instrument;
- (b) the instrument has been registered in the Land Registry under the Land Registration Ordinance (Cap. 128); and
- (c) the instrument is produced in evidence by any person other than the buyer under the instrument.

We will introduce committee stage amendments accordingly.

6. As regards Members' query on the basis of determining the amount of the BSD unpaid or underpaid in the above mentioned scenario, we would like to clarify that stamp duty is charged on instruments. Hence, IRD will take the consideration or value of the residential

property as at the date of the chargeable agreement for sale (whichever is the higher) as the basis to determine the amount of the BSD unpaid or underpaid.

Item 32 of LC Paper No. CB(1)893/12-13/(02)

7. The seller and the buyer involved in a property transaction are jointly and severally liable for paying the Special Stamp Duty (SSD), if any. Under the proposed enhanced SSD regime, whether a residential property transaction is chargeable with SSD depends on whether the transaction constitutes a resale of the property concerned within three years. This should be clear to both the seller and the buyer. The existing mechanism has been functioning effectively since the SSD was introduced in November 2010 and we have no plan to alter the mechanism.

Item 34 of LC Paper No. CB(1)893/12-13/(02)

8. The Administration will introduce committee stage amendments to improve the drafting of section 29DB(8)(c) of the Bill, to the effect that the mortgagee referred to in that section must be the same mortgagee of the mortgaged property.

Item 36 of LC Paper No. CB(1)893/12-13/(02)

9. The Administration has shared with the Hong Kong Association of Banks our response to its previous submission (LC Paper No. CB(1)893/12-13/(02)). We have further explained to the Association our view that a mortgaged property can only be acquired by or transferred to the mortgagee by way of conveyance, and that it would not be necessary to exempt an agreement for sale from the BSD in that context. The Administration has not received any further view from the Hong Kong Association of Banks.

Meeting with the Law Society on 3 June 2013

10. The Administration met with the Law Society on 3 June 2013 to further exchange views with their Members, in particular on issues as set out in its submission of 28 May 2013. Apart from the issue on the

exemption for replacement purchases from the BSD and the issue of admissibility of documents as evidence referred to in paragraphs 3 to 6 above, the Administration has also clarified other issues of concern. Details are set out in the ensuing paragraphs.

Penalty of late payment of the BSD

11. At the meeting on 3 June, the Law Society raised concern that the penalty of late payment of the BSD was excessive and disproportionate. As the Administration has explained in LC Paper No. CB(1)893/12-13/(02), the maximum penalty for late stamping (up to 10 times of the stamp duty payable) is not unique for the BSD, but is the standard level of maximum penalty in the Stamp Duty Ordinance (Cap.117) applicable to all types of duties under the stamp duty regime. We consider it prudent and reasonable to apply the established penalty system of the stamp duty regime to the late payment of the BSD. We are mindful of the message that we might be sending to the market if we deviate from the established penalty system specifically for the BSD.

Resulting or constructive trusts

12. Law Society has also expressed concern that an acquisition of a residential property may involve provision of funds by persons other than the buyer, which may create resulting or constructive trusts. The Law Society has enquired whether such an acquisition will be subject to the BSD, and how IRD can be satisfied that the HKPR concerned is acting on his own behalf. The Law Society also points out the difficulty for the solicitor concerned to verify the statutory declaration. We would like to clarify that, in an acquisition involving funds provided by persons other than the buyer, such contribution may either be provided by way of a gift, a loan or an entrustment. The buyer (who is in full cognizance of the facts and circumstances surrounding the contribution) is in the best position to determine the nature of such contribution and to state whether he or she acts in his or her own behalf in the acquisition. The requirement to make a declaration would probably prompt the purchaser to make a conscious determination of the true nature of the contribution before the declaration is made. We believe the matter will be straightforward in most cases. However, where the purpose of the contribution is not clearly communicated by the contributor to the purchaser; or where the purchaser, for whatever reason, is not sure about the true nature of such contribution, it will not be difficult for him to ascertain from or establish the true nature of such contribution with the

contributor before execution of the declaration.

13. The Administration would also like to clarify that the solicitor acting for the purchaser in the transaction is not expected to confirm the capacity of the HKPR buyer. IRD will have to do so in order to determine the correct amount of duty payable on the instrument. Under the existing system, the solicitor acting for the parties to the transaction are not expected to determine the correct amount of duty payable on the instrument or whether it is in fact understamped (e.g. by virtue of stated consideration being less than the market value). Likewise, under the proposed BSD regime, it is the responsibility of IRD, not the solicitor, to determine if the BSD is payable.

Members' request for concrete examples to illustrate possible loopholes and operational difficulties arising from abuse of a self-declaration mechanism for the purpose of exempting companies whose shareholders are HKPRs from the BSD

14. At the Bills Committee meeting on 20 May 2013, Members requested the Administration to provide concrete examples to illustrate possible loopholes and operational difficulties arising from abuse of a self-declaration mechanism for the purpose of exempting companies whose shareholders are HKPRs from the BSD. The information requested, which is prepared based on IRD's experience in dealing with stamp duty cases, is at **Annex II** for reference. We would like to emphasise that the Administration is not assuming that companies would abuse the self-declaration mechanism concerned 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 demand-management measure in cooling down the property market and in according priority to HKPRs in addressing their home ownership needs.

**Transport and Housing Bureau
June 2013**

Annex I

Additional scenarios of replacement purchases proposed to be exempted from the Buyer's Stamp Duty

Relevant ordinance	Justification
1. Section 4(1) of the Mass Transit Railway (Land Resumption and Related Provisions) Ordinance (Cap.276)	<ul style="list-style-type: none">♦ This provision empowers the Chief Executive to direct that any land within a railway area be resumed for the purposes of and incidental to the construction and operation of a Mass Transit Railway.♦ Under such land resumption, non-HKPR property owner affected are being made to sell or part with his / her residential property not on his / her own volition and should be entitled to the BSD exemption for a replacement purchase.
2. Section 13(1) of the Roads (Works, Use and Compensation) Ordinance (Cap.370)	<ul style="list-style-type: none">♦ This provision empowers the Chief Executive to direct that any land proposed for resumption in a major works scheme in relation to roads be resumed for the purposes of or incidental to the works.♦ Under such land resumption, non-HKPR property owner affected are being made to sell or part with his / her residential property not on his / her own volition and should be entitled to the BSD exemption for a replacement purchase.

Relevant ordinance	Justification
<p>3. Sections 16 and 28(1) of the Railways Ordinance (Cap.519)</p>	<ul style="list-style-type: none"> ♦ Section 16 empowers the Chief Executive to direct that any land proposed to be resumed in a railway scheme be resumed for the purposes of or incidental to the scheme. ♦ Under such land resumption, non-HKPR property owner affected are being made to sell or part with his / her residential property not on his / her own volition and should be entitled to the BSD exemption for a replacement purchase. ♦ Separately, section 28(1) empowers the Chief Executive to, on application, order the resumption of a land contiguous or adjacent to another land that is resumed, if he is satisfied that the latter is reasonably necessary to the use and enjoyment of the former; and it would be just and equitable to make the resumption order. ♦ While such land resumption is initiated by the land owner, the land resumption that affects the enjoyment of his / her land is carried out by the Government, and thus the land owner should also be entitled to the BSD exemption for a replacement purchase.

Relevant ordinance	Justification
4. Section 3 of the Land Acquisition (Possessory Title) Ordinance (Cap.130)	<ul style="list-style-type: none"> ♦ The provisions stipulates that if the Chief Executive in Council decides that the acquisition of any land is required for a public purpose, the Director of Lands may make an acquisition order if it appears that the land is held under a possessory title by virtue of the Limitation Ordinance (Cap.347). ♦ Under such acquisitions, non-HKPR property owner affected are being made to sell or part with his or / residential property not on his / her own volition and should be entitled to the BSD exemption for a replacement purchase.
5. Section 37(2) of the Land Drainage Ordinance (Cap.446)	<ul style="list-style-type: none"> ♦ The provision stipulates that, if any land has been rendered incapable of reasonably beneficial use as a result of the execution by the Drainage Authority of any works under the Ordinance, the Chief Executive may, on application, make an order to resume the land in question. ♦ While such land resumption is initiated by the land owner, the works rendering the land concerned incapable of reasonably beneficial use is carried out by the Government, and thus the land owner should also be entitled to the BSD exemption for a replacement purchase.

Concrete examples to illustrate possible loopholes and operational difficulties arising from abuse of a self-declaration mechanism for the purpose of exempting companies whose shareholders are HKPRs from the BSD

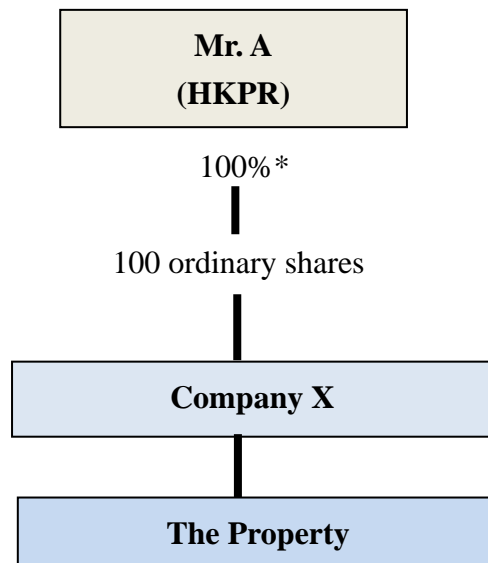
As requested by Members at the Bills Committee meeting on 20 May, following are examples to illustrate possible loopholes and operational difficulties arising from abuse of a self-declaration mechanism for the purpose of exempting companies whose shareholders are HKPRs from the BSD. The examples are based on IRD's experience in handling stamp duty cases.

Background scenario

- It is assumed that the proposed BSD exemption for HKPR-owned companies has been put in place. Each HKPR shareholder of the companies would have to declare that he / she holds the shares of the company concerned on his / her own behalf; and that he / she will not transfer his / her ownership of the company to a non-HKPR (including companies).
- Company X is incorporated in Hong Kong with 100 issued ordinary shares of \$1 each. There is only one shareholder, Mr. A, in the company. Mr. A is a HKPR and serves as the only director of Company X.
- In December 2012, Company X entered into an agreement for sale and purchase ("the Agreement") to purchase a residential property ("the Property"). The Property was assigned to Company X in January 2013.
- Company X submitted the Agreement to the Stamp Office ("SO") for stamping and claimed exemption from Buyer's Stamp Duty ("BSD") on grounds that its shareholder and director was a HKPR.
- In support of the exemption claim, Company X, through its director, made a statutory declaration affirming that it acquired the Property on its own

behalf. Mr. A also made statutory declaration affirming that he holds the shares in Company X on his own behalf and he is a HKPR.

- Any change in Mr A's legal or beneficial interests in Company X, or issue of new shares by Company X ("Relevant Events") has to be reported to the SO with similar declaration(s) by new shareholder(s) to be made. The holding structure of the company is illustrated as follows.



Note

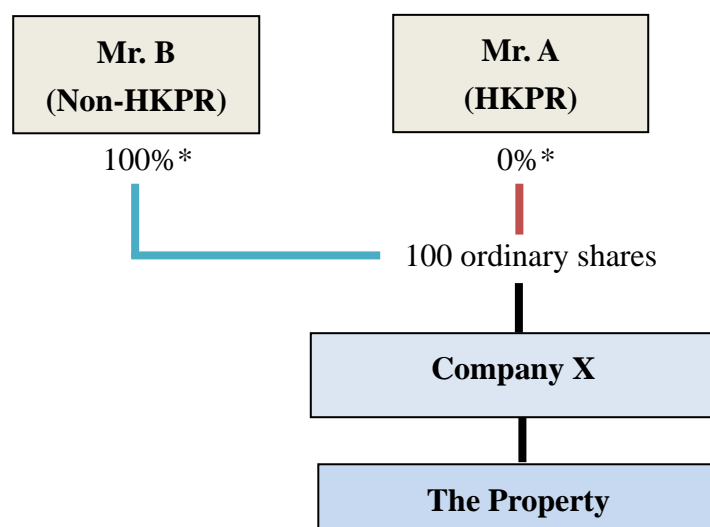
* % of controlling interest in Company X

— : holding of both legal and beneficial interests

Examples of loopholes

Example 1 - Nomination / Declaration of Trust / Power of Attorney

- After Company X has acquired the BSD exemption, Mr. A then transfers or confers to Mr. B, a non-HKPR, the beneficial interest or controlling interest of all his shares in Company X and executed a nominee shareholder agreement, a declaration of trust or a power of attorney (“Relevant Document”). To protect his interest, Mr. B may ask Mr. A, for example, to sign blank instrument of transfer and surrender all seals of Company X. After the transfer, Mr. B has effectively acquired all the interest in Company X and through which the Property indirectly. Under the nominee shareholder agreement or declaration of trust, Mr. A will act for Mr. B according to the latter’s instructions while by the power of attorney, Mr. A is appointed by Mr. B to act on his behalf though in fact Mr. B has become the beneficial owner of the shares. Please see the diagram below for the new holding structure.



Note

* % of controlling interest in Company X

— : holding of both legal and beneficial interests

— : holding of legal interest only

— : holding of beneficial interest only

- Since the Relevant Document does not constitute an instrument of transfer and there is no change of legal title in the shares, Mr. A remains the registered shareholder of Company X. The Relevant Document is not required for registration in its share register, nor reporting to the Companies Registry (“CR”)¹.
- Pursuant to the notification requirement, Mr. A, upon disposal of his shares to Mr. B, should notify the SO accordingly. However, if Mr. A fails to do so, the SO can hardly reveal the Relevant Event nor recover the BSD, given the absence of such information from the share register of Company X or the returns and documents filed by Company X to the CR.

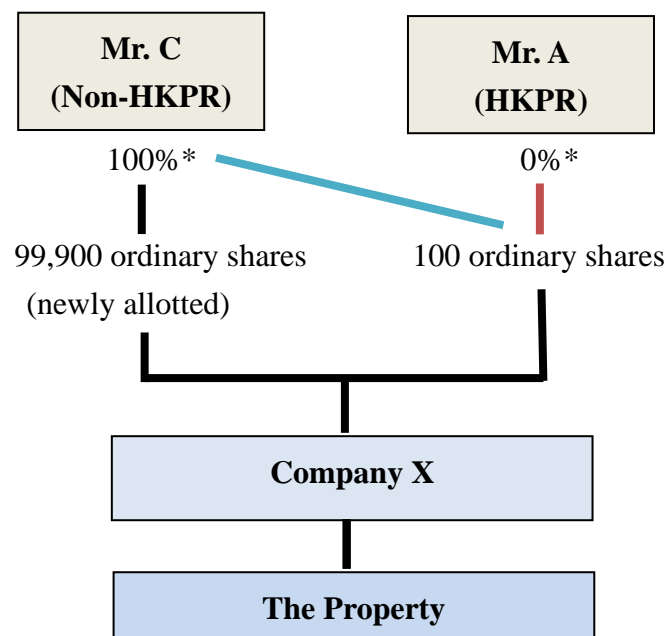
Example 2

- The only variation in this example from Example 1 is that Mr. A is a close ally or employee of Mr. B. On the instruction of and with the provision of fund by Mr. B, Mr. A has incorporated Company X and caused Company X to acquire the Property. After Company X has acquired the BSD exemption, Mr. A then transfers or confers to Mr. B the beneficial interest or controlling interest of all his shares in Company X in the same way as Example 1.
- Unless an in-depth investigation into the bank accounts of Mr. A and Company X is conducted, the SO would not be able to ascertain that Mr. A is only the trustee of Mr. B and recoup the BSD from Company X.

¹ Section 101 of the Companies Ordinance (Cap. 32) (“CO”) (or section 634 of the new Companies Ordinance (Ordinance 28 of 2012) (“New CO”) estimated to commence operation in 2014) provides that no notice of any trust (expressed, implied or constructive) shall be entered on the share register, or receivable by the Registrar of Companies.

Example 3 - Issue of new shares

- Company X has allotted 99,900 new ordinary shares to Mr. C², a non-HKPR. On its share register, Company X has recorded Mr. C as the owner of the new shares. It has also filed a return of allotment to the CR reporting that the new shares have been allotted to Mr. C³. Mr. A then disposes his beneficial interest or controlling interest in 100 shares to Mr. C as in Example 1 and executes a nominee shareholder agreement, a declaration of trust or a power of attorney, but remains as a nominee shareholder for Mr. C.
- After the allotment and acquisition of 100 shares from Mr. A, Mr. C has effectively acquired the controlling interest in Company X and through which the Property indirectly. Please see diagram below for the new holding structure.



Note

* % of controlling interest in Company X

— : holding of both legal and beneficial interests

— : holding of legal interest only

— : holding of beneficial interest only

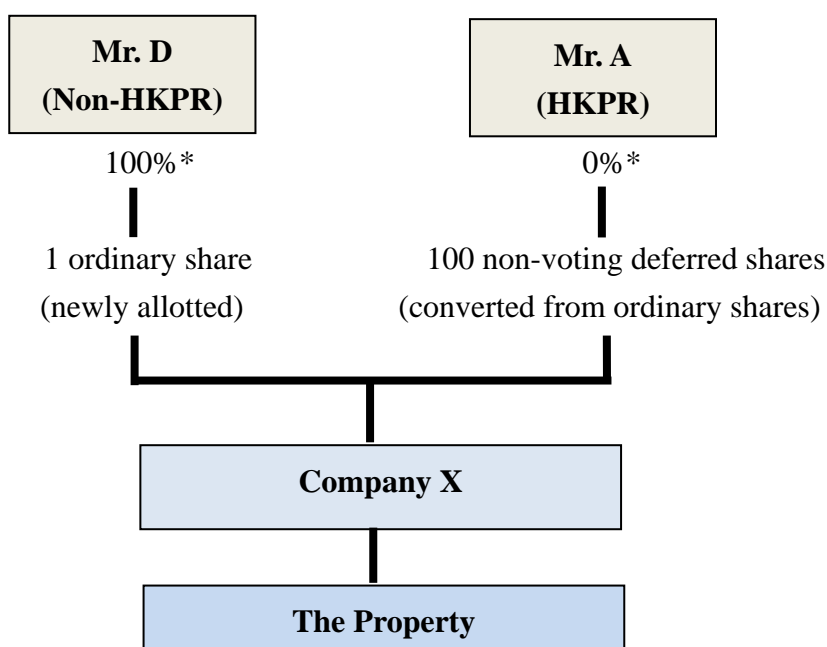
² The share allotment is not chargeable with stamp duty as it does not constitute a sale or purchase of shares: section 19(16) of the SDO.

³ Section 45(1) of the CO (or section 142(1) of the New CO) provides that a company which makes any allotment of its shares shall within 1 month thereafter deliver a return of the allotments in the specified form to the Registrar of Companies for registration.

- The allotment of new shares and the disposal of 100 shares constitute Relevant Events. However, the SO does not have information on the allotment of new shares as they are not chargeable with stamp duty. The SO will have no knowledge of the disposal of the 100 shares if it is withheld by the parties.
- It would be unrealistic for SO to check with the CR or enquire the relevant persons to dig out the Relevant Event, as it is not practical, if not impossible, for SO to continuously check with CR or enquire the relevant persons as to whether each and every company that has obtained the exemption from the BSD has filed any return for allotment of shares. Moreover, in the example concerned, Mr. C now has a free hand to dispose of the Property and get all the proceeds from the sale transaction any time. By the time the Relevant Event is revealed, Company X could have sold the Property and Mr. C might have left Hong Kong already.

Example 4 - Reclassification of issued shares and issue of new shares

- Company X has allotted 1 new ordinary share to Mr. D, a non-HKPR. At the same time, the 100 ordinary shares held by Mr. A are converted into non-voting deferred shares which are merely entitled to participate in Company X's profits and assets (upon winding-up) when the relevant profits and assets reach an astronomical amount.
- On its share register, Company X has recorded Mr. D as the owner of 1 ordinary share, whilst Mr. A as the owner of 100 deferred shares. Company X has also filed to the CR (a) a return of allotment in respect of the 1 ordinary share allotted to Mr. D⁴; and (b) a special resolution for the alteration of the rights attached to the shares held by Mr. A⁵.
- In terms of the amount of issued share capital, Mr. D acquires just approximately 1% interest in Company X. However, since Mr. A's deferred shares are devoid of voting rights, Mr. D has effectively obtained the absolute control of Company X and through which the Property indirectly. Please see diagram below for the new holding structure.



⁴ See footnote 3

⁵ Section 64A of the CO (or section 184(1) of the New CO) provides that every company having its share capital divided into different classes of shares shall deliver to the CR for filing a copy of any document or resolution attaching rights to any class of shares in the company.

Note

* % of controlling interest in Company X

— : holding of both legal and beneficial interests

— : holding of legal interest only

— : holding of beneficial interest only

- Similar to Example 3, the SO does not have information on the allotment of new shares nor the alteration of the rights of shares as the relevant special resolution is filed to the CR only. In order to track any such Relevant Event, the SO has to deploy substantive resources to monitor continuously with the CR or enquire the relevant persons in order to have the chance of discovery of the allotment of shares or alteration of shares' rights. It is not practical, if not impossible. On the other hand, as Mr. D now has a free hand to dispose of the Property and get all the proceeds from the sale transaction any time, by the time the Relevant Event is revealed, Company X could have sold the property and Mr. D might have left Hong Kong already.