

**The Government's response to the issues  
raised at the meetings of the Bills Committee on  
the Stamp Duty (Amendment) Bill 2012 held on 16 September 2013**

This paper sets out our response to the issues raised in the letter from the Legislative Council Secretariat of 17 September 2013 (LC Paper No. CB(1) 1843/12-13(01) refers).

**The proposal to exempt companies owned by Hong Kong permanent residents (HKPRs) from the Buyer's Stamp Duty (BSD)**

2. The Government has thoroughly examined Members' suggestions to exempt HKPR-owned companies from the BSD from the perspectives of the policy objective of the BSD; the effectiveness of the BSD; and the likely loopholes which would be created. The Administration has grave concerns on all these aspects and hence does not consider the suggested exemption to be appropriate.

3. We would like to reiterate that the Government is determined to ensure the healthy and stable development of the property market. The demand-side management measures, including the BSD, have effectively curbed market exuberance and reversed the community's irrational expectation that property prices could only go up further, thereby reducing the risk of a property market bubble. Until the property market returns to a normal state, the Government has no intention to withdraw or relax these measures. If we were to withdraw or relax the measures now, there would be an inevitable impact on the property market, which send the wrong message to the community and call into question our determination to stabilize the property market. This may in turn trigger a return to the cycle of irrational exuberance in the property market again, and undermine the Government's efforts to cool off the market. This would expose the property market to an even higher risk of a property bubble, which would be to the detriment of the macro economy and ultimately, affecting all trades negatively.

4. As explained in our previous written replies to the Bills Committee, exempting companies owned by HKPRs is not in line with the policy objective of the BSD to accord priority to the home ownership needs of HKPRs. Moreover, as elaborated in the following paragraphs, the above exemption would create loopholes that are very difficult to plug. Under the current situation where the supply remains tight and the property market is still exuberant, as a responsible Government, we cannot simply ignore the obvious loopholes that may be created by exempting HKPR-owned companies from the

BSD, since these would undermine the effectiveness of the measures to cool down the property market and accord priority to HKPRs in addressing their home ownership needs.

5. Introducing exemptions for companies will create loopholes that can be exploited to evade the BSD. It is well known that the cost of setting up a company in Hong Kong is low and the procedures involved are simple. Besides, to acquire the ownership and control of the assets (including residential properties) through acquiring the ownership of the company holding such assets is a commercial activity commonly found in Hong Kong. The crux of the problem is that there are numerous means to transfer company shares. Under the current regime, the validity of the transfer of the ownership in the company would not be affected even if such transactions<sup>1</sup> are not registered with the Companies Registry and the instruments involved which are chargeable to stamp duty are not presented to the Inland Revenue Department (IRD) for stamping. **In other words, if HKPR-owned companies were exempted from the BSD, people outside Hong Kong could make use of various types of share transfer which would be hard to uncover or trace** (such as asking a HKPR, who is the only shareholder and director of a company, to sign a blank instrument of share transfer and provide all company seals to people outside Hong Kong) **to acquire the beneficial interest of the company quite easily in a concealed way. This would in effect allow that person outside Hong Kong effectively to gain control of the residential property owned by the company, hence evading the BSD.** As we have repeatedly pointed out, to plug these loopholes, fundamental changes to the existing effective taxation and company regimes will be required. As the BSD is an extraordinary measure introduced under exceptional circumstances, we consider that such change is not in line with the principle that the remedy should be proportionate to the problem concerned.

6. Even if the exemption was provided by way of a refund after a certain period of time alongside a statutory declaration mechanism and heavier penalties as suggested by some Members, the aforementioned loopholes still could not be effectively plugged. As we have repeatedly explained, share transfers through the means mentioned above can effectively get around verification provided under the current regime, making it extremely difficult, if not impracticable, for the IRD to ascertain if there are any changes in the declaration made by the relevant HKPR shareholders. Therefore, any abuse of such a declaration mechanism could not be detected easily and effectively. The penalty, however

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<sup>1</sup> If the transfers of company shares are executed by means of nominee shareholder agreement, declaration of trust or power of attorney etc., such transactions are not required to be registered with the Companies Registry. Although the instruments executing such transactions are chargeable to stamp duty, the validity of the transfer of ownership in the company would not be affected even if the instruments involved are not stamped.

heavy, could hardly be of any deterrent value. **In view of the substantial amount of BSD at stake** (i.e. 15% of the consideration of the relevant residential property), coupled with the fact that there are such straightforward means to conceal the transfer of shares, the proposed exemption provide **substantial incentive to evade the BSD. We should not underestimate the risk of BSD evasion arising from the aforesaid loopholes.**

*Difference between declarations made by a HKPR as an individual and as a company shareholder*

7. Some Members have queried, as far as the BSD is concerned, why the Government accepts the statutory declaration made by a HKPR as an individual buyer but considers that the statutory declaration made by a HKPR as a company shareholder would create loopholes that are difficult to plug. **In this regard, we would like to emphasize once again that for the BSD, the statutory declaration made by an individual buyer is very different from that made by a company shareholder in terms of the content of the declaration, the verification work and the risk of BSD evasion.**

8. In LC Paper No. CB(1)893/12-13(01), we have already explained that the declaration for individual buyers as proposed by the Government requires a HKPR, who is an individual buyer, to declare his/her status as a HKPR and that he/she is acting on his/her own behalf in the acquisition of the residential property concerned. Based on the content of the declaration, the relevant transaction instrument will be stamped by the IRD. The individual buyer concerned can then register the stamped instrument with the Land Registry and become the registered owner whereby his/her beneficial interest in the residential property would be protected. Subsequently, the IRD can ascertain whether the registered owner of the residential property concerned is the HKPR making the statutory declaration by checking the property registration records of the Land Registry. As regards the risk of BSD evasion, it should be noted that transaction instruments which have not been stamped by the IRD, including secret agreements, are not registrable with the Land Registry. As such, if a person outside Hong Kong enters into a secret agreement with a HKPR with a view to using the identity of the HKPR concerned to acquire a residential property, although he/she may evade the BSD, it is difficult for him/her to prevent the HKPR concerned, who is the registered property owner in the Land Registry, from executing an assignment selling the residential property. As a result, if a person outside Hong Kong makes use of the identity of a HKPR to acquire a residential property for the purpose of evading BSD, such person has to bear a high risk of losing his/her beneficial interest in the residential property.

9. The declaration for companies as proposed by Members, however, requires each HKPR shareholder of a company to declare that he/she has not

transferred his/her company shares to non-HKPR(s) (including person outside Hong Kong). However, as we have explained above, a person outside Hong Kong can acquire indirectly the ownership and control of a residential property held by a HKPR-owned company and evade the BSD easily by acquiring the company shares from the HKPR shareholders by various means which are difficult to be unearthed and traced, yet the validity of the transfer of the ownership in the company will not be affected under these concealed transactions. Moreover, the risk of the HKPRs who have transferred the beneficial interest of their shares to the person outside Hong Kong to sell the company shares is rather low as the person outside Hong Kong can easily assume effective control of the company shares (e.g. by controlling the directors of the company and imposing restriction on transfer of shares). As there is virtually no way for the IRD to ascertain if each HKPR shareholder of a company has ever transferred his/her company shares during the specified period of time, the person outside Hong Kong can easily evade the BSD by acquiring shares of a HKPR-owned company in a concealed way with very low risk. The proposed exemption for HKPR-owned companies is thus vulnerable to abuse, and the effectiveness of the BSD would be severely undermined.

10. As indicated above, the purpose of the Government's current proposal to exempt HKPRs from the BSD is to accord priority to address the HKPRs' home ownership needs in the midst of the current tight housing supply. The policy intent is clear and legitimate. If the scope of exemption were to be extended to companies with HKPR shareholders or with less than a certain number of HKPR shareholders, **it would call into question whether the level playing field among companies in Hong Kong can be maintained. The establishment of an exemption for certain types of company to the exclusion of others gives rise to questions over the equity of such exemptions.**

11. **In conclusion, with the objectives to maintain the stability of the property market, to avoid disseminating the wrong message to the market and avoid creating loopholes, while bearing in mind that the effectiveness of the BSD should not be severely undermined, the stance of the Government is that it is necessary to charge the BSD on all companies for their acquisitions of residential property.**

**The proposal to exempt charitable organizations that are exempted from tax under section 88 of the Inland Revenue Ordinance (Cap.112) (IRO) from the BSD**

12. As the Government has explained in LC Paper No. CB(1)1618/12-13(02), the Government has carefully listened to the views of

Members on the proposed exemption of charitable organisations which are exempted from tax under section 88 of the IRO from the BSD. We need to emphasize that the objective of introducing the BSD is to **accord priority to the home ownership needs of HKPRs** in the midst of the current exceptional situation by increasing the transaction costs of non-HKPRs in acquiring residential properties. Any exemption or refund will undermine the effectiveness of the BSD in achieving this policy objective.

13. The Government notes that some charitable organisations might acquire residential properties for investment purpose to support their operation. As a matter of fact, while the IRO does not prohibit charitable organisations from engaging in investment or trading activities not in the course of carrying out of their expressed charitable objects, the profits so generated will **not** be exempted from profits tax. It is worth noting that a charitable organization can be formed through different structure, including a company incorporated under the Companies Ordinance (Cap.32), a trust and a society established under the Societies Ordinance (Cap.151) etc. Indeed, over 70% of the tax-exempt charitable organisations are in the form of companies. Moreover, there is no statutory definition of what constitutes a charity or a charitable purpose in Hong Kong at present. The IRD has all along made reference to the common law in determining charitable bodies and charitable purposes under section 88 of the IRO. The charitable purposes are therefore very diverse and subject to dispute. As we have repeatedly stated, the scope of section 88 of the IRO is confined to whether individual charitable organizations are liable to tax. The IRD is only responsible for the tax exemption aspect of charitable organizations and has not been involved in regulating the day-to-day activities of the charitable organizations, including their fund-raising activities, financial transparency, governance structure, etc. If tax-exempt charitable organisations were to be exempted from the BSD, there would be a serious risk of abuse of the exemption by setting up a new charitable organization in the form of company to claim the exemption and it will be very difficult for the IRD to verify if the residential property concerned has been used for charitable purpose.

14. The Government considers that, under the current situation where supply remains tight and the market situation remains unstable, it is necessary and legitimate to accord priority to the home ownership needs of HKPRs. The Government is concerned that granting BSD exemption to charitable organization might stimulate the overall demand for residential properties, which runs contrary to the policy intention of the BSD. While the Government recognises that charitable organisations may have the need to purchase residential properties, we wish to reiterate that **we should be careful in determining the priorities of different sectors' demands for residential properties under the current market condition.** As such, we do not consider it appropriate to grant BSD exemption or refund to charitable organisations.

15. Drawing reference from the present ad valorem stamp duty and the Special Stamp Duty regimes, we have proposed in the Stamp Duty (Amendment) Bill 2012 (the Bill) that gifts of residential property to charitable organisations exempted from tax under section 88 of the IRO should be exempted from the BSD. We are of the view that the Bill has struck the right balance in preserving the policy objective of the BSD and addressing the needs of charitable organisations.

16. As mentioned above, charitable organizations exempted from tax under section 88 of the IRO have been established in different legal forms, such as companies, trusts and societies. As at 31 March 2013, there were 7 592 exempted charities. Their breakdown by the various legal forms was as follows –

<u>Legal Form</u>	<u>Number</u>
Corporation	5 651
Society	796
Trust	428
Others <sup>2</sup>	717
<b>Total</b>	<b>7 592</b>

Generally speaking, a tax-exempt charitable organization must be established for purposes which are exclusively charitable according to law. In processing the tax exemption applications of charities, IRD follows case law developed through court decisions. According to case law, “charitable purposes” may include relief of poor people, relief of victims of a particular disaster, relief of sickness, relief of physically and mentally disabled, establishment or maintenance of non-profit-making schools, provision of scholarships, diffusion of knowledge of particular academic subjects, establishment or maintenance of a church, establishment of religious institutions of a public character, prevention of cruelty to animals, protection and safeguarding of the environment or countryside. Most of the tax-exempt charitable organizations have more than one charitable object in their governing instruments. However, IRD has not maintained any updated statistical breakdown of the tax-exempt charitable organizations according to their charitable purposes.

### **Constitutionality of the Special Stamp Duty (SSD) and the BSD**

17. We are asked to provide written advice on whether the SSD and BSD

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<sup>2</sup> “Others” includes incorporated management committees established under the Education Ordinance (Cap. 279), statutory bodies and ad hoc special committees.

are constitutional and legitimate taxation in conformity with the Basic Law, in particular Articles 25 and 105. As a matter of fact, in response to previous comments of Members and request of the Bills Committee, we have already provided written replies on the issue. Details are in items 8 and 16 of the Annex to LC Paper No. CB(1)692/12-13(01); item 21 of the Annex to LC Paper No. CB(1)893/12-13(02); paragraphs 17 to 21 of LC Paper No. CB(1)893/12-13(01); LC Paper No. CB(1)770/12-13(02); LC Paper No. CB(1)973/12-13(02), as well as LC Paper No. CB(1) 1367/12-13(03). In short, the SSD and the BSD are legitimate taxation governed by Basic Law Article 108 instead of Article 105, and they do not constitute a breach of Article 25 of the Basic Law. Article 25 of the Basic Law does not invariably require exact equality amongst all Hong Kong residents, as far as the differences in legal treatment may be justified for good reason. In this regard, we have repeatedly explained that the SSD and the BSD pursue legitimate objectives, and are proportionate and rationally connected to such objectives.

### **Other follow-up issues**

18. The Government has already provided the Legislative Council Secretariat on 24 September 2013 with a copy of the opening remarks made by the Secretary for Transport and Housing at the Bills Committee meeting on 16 September 2013. The Government has also provided a reply to the Hon Abraham Shek's letter dated 12 September 2013. We understand that the Hon Abraham Shek and the Hon Andrew Leung have submitted proposed amendments to the Bill to the LegCo Secretariat on 24 September 2013. We will examine the proposed amendments in detail and revert separately.

**Transport and Housing Bureau  
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