LC Paper No. CB(1)1336/12-13(01)
(English version only)

Avoiding double stamp duty

12th June 2013

Reading this morning's *Suspended China Morning Post*, we saw a headline "Emperor buys Wan Chai office block for HK$1.6b" (Emperor being a company, not a Japanese monarch). The article goes on to describe the purchase by Emperor International Holdings Ltd (**EIH**, 0163) of the office building currently known as Wing Hang Finance Centre, at 60 Gloucester Road, Wanchai, from Wing Hang Bank, Ltd (**WHB**, 0302). But that isn't what happened. The property wasn't bought or sold at all.

Although WHB announced on 8-Mar-2013 that its 100% subsidiary, Honfirst Land Ltd (**Honfirst**), had appointed an agent to tender the sale of the property, what actually happened is that WHB sold Honfirst to EIH. By selling the company for $1.588bn (everyone loves an 8), the parties legally avoided the proposed 8.5% double stamp duty (**DSD**) on real estate which is currently on the table in LegCo, and will pay 0.2% on the shares instead. Your editor will be speaking to LegCo against DSD tomorrow morning, 13-Jun-2013. Many other delegations are attending - the list is here along with submissions.

DSD on this property would have been a whopping $134.98m, if the parties had been willing to deal on that basis at all. Instead, the transfer of Honfirst will incur stamp duty of 0.2% ($3.18m), which is the rate of stamp duty on the transfer of HK-registered shares. Honfirst is incorporated in HK, but if it had been incorporated in the British Virgin Islands (and the register kept offshore) or held by a BVI company which was transferred instead, then there would have been no stamp duty at all.

According to the EIH announcement, Honfirst had turnover of $33.77m in 2012. That is presumably the rental income, possibly including management fees. It may include income from other properties too. The WHB announcement says that on 30-Apr-2013 Honfirst "sold all other commercial properties owned by it to the Bank". That left Honfirst as a single-asset vehicle, ready for sale. The intra-group transfer of the other properties would be exempt from stamp duty.

So we'll estimate that the gross yield on the property at the transaction value is about 2% ($32m). That means that paying 8.5% stamp duty would have been equivalent to 4.25 years' rent, a huge penalty for a transaction. Even if you share that equally between the parties, it means each side giving up over 2 years' rent, and that would have made it substantially less attractive to deal at all.

In future, more transactions will be done by company transfer than in the past. There is always a risk that the company has hidden liabilities, but when the tax savings are so great, that will often outweigh the risk. If the vendor is reputable (a licensed bank in this case), then lawyers can reduce that risk with warranties, and insurers may offer guarantees. That really leaves stamp duty as an optional tax on properties held by companies, but a punitive tax on individuals and small businesses who cannot find suitable single-asset vehicles to buy in the lower end of the market.

The corporate market

In a LegCo answer on 8-May-2013, the Government gave data on the number of residential transactions in various price bands involving corporate buyers in the last 4 years. We will ignore 2012, because on 26-Oct-2012, the Government proposed a 15% "Buyer's Stamp Duty" (**BSD**, which should really be called "Foreigner's Stamp Duty") which applies to any buyer other than a permanent resident. Companies buying residential property after that will (if the BSD law is passed) have to pay 15%, so very few such deals are done. By the way, the BSD law is still not passed - so there is a chance that LegCo will come to its senses and stop it. The Bills Committee is here.

However, what the LegCo answer shows is that above HK$20m, in 2011 (the last full year before BSD), 60.5% of transactions by value involved a corporate buyer. The figure in 2010 was 67.3% and in 2009 was 66.4%. This is not a new phenomenon. **Basically about two-thirds of homes above $20m by value are already owned by companies**. Even between $8m and $20m, 30.1% of transactions by value in 2011 involved a corporate buyer. And those were just the transactions you could see, not the transfers of companies which own property.

So, although it is now prohibitive for companies to buy residential property (they would have to pay BSD+DSD=23.5% if both laws are passed), there is already a large stock of higher-value properties held by single-asset companies. Those companies can be transferred, paying either 0.2% or zero stamp duty, depending on whether they are incorporated in HK or overseas. Not only that, but buying a company gives you the flexibility to sell it later, should the need arise, without the punitive Special Stamp Duty on resale of residential properties within 3 years. The situation is similar for commercial properties, but without SSD and without any DSD exemption for first-time buyers who are permanent residents.

As a result of Double Stamp Duty, a large portion of the middle and high-end market will simply move off the Land Registry's radar and be carried out through company transfers, and if they are non-HK companies, then they won't even show up on the Inland Revenue's stamp duty radar. Meanwhile, owners and potential buyers of properties not already wrapped up in a corporate shell will be frozen out of the market by the deterrent taxes. DSD was never a demand-side measure, as the government claims, but a volume-suppressing measure. It is just the latest example in a series of interventionist measures (not just in property) from a Government which is hell-bent on destroying our free market economy.