

**PRELIMINARY SUBMISSIONS BY THE LAW SOCIETY'S PROPERTY
COMMITTEE ON THE STAMP DUTY (AMENDMENT) (NO.2) BILL 2010**

Background

1. On 19 November 2010, the Government announced through the Financial Secretary, inter alia, a proposal to introduce Special Stamp Duty (“SSD”) for certain transactions on residential properties in Hong Kong. The SSD is to be payable on top of the existing Ad Valorem Stamp Duty (“AVSD”).
2. The Inland Revenue Department (“IRD”) issued a letter on the same date of 19 November 2010 to The Law Society advising of the details of the new policy and the intention to give retrospective effect to the new legislation.
3. As the SSD was intended to generally affect resale transactions of residential properties “acquired” on or after 20 November 2010 (i.e. the day immediately following the date the Government’s announcement of policy), The Law Society sought clarifications from the IRD before the gazettal of the Bill on various aspects of the SSD policy, including, in particular, the meanings of the important concepts of “*acquired*” and “*date of acquisition*”.
4. The Stamp Duty (Amendment) (No. 2) Bill (“the Bill”) to implement the SSD proposal was gazetted on 3 December 2010, 2 weeks after the Government announced the SSD policy.
5. The stated objectives of the SSD policy, as indicated in the Transport and Housing Bureau (“THB”)’s Legislative Council Brief on the Bill, are “*to curb short-term speculative activities by substantially increasing the costs to speculators, reduce the risk of the development of an asset bubble and ensure the healthy and stable operation of the property market.*” The THB’s paper further stated that “*At the same time, genuine home buyers and long terms investors*

should not be affected by those measures.”

6. The Law Society’s Property Committee (“the Committee”) has met once to briefly discuss the Bill since its gazettal. Given the important implications of the new legislative proposals on the conveyancing practice, at its recommendation, the Law Society issued a Circular to solicit members’ views on the Bill. Whilst the Committee will meet further to consider the views received from the profession, it would like to first highlight the following preliminary concerns on the proposed legislation for the consideration of the Bills Committee:

Preliminary Concerns of the Committee

Meaning of “acquired” and “disposed of”

7. Under the proposed new Sections 29CA and 29DA of the Stamp Duty Ordinance (“*the Ordinance*”), subject to certain exemptions, SSD will be payable on an agreement for sale or a conveyance on sale of any residential property which was “*acquired*” on or after 20 November 2010 and “*disposed of*” within 24 months beginning on the day on which the vendor under the agreement “*acquired*” the property.
8. Under the proposed new Heads 1(1AA) and 1(1B) in the First Schedule of the Ordinance, the amount of SSD payable will be calculated based on the stated consideration for the transaction or the market value of the property as assessed by the Collector of Stamp Revenue, whichever is the higher, at different rates for different “*holding periods*”:
 - (a) 15% if the property has been held for 6 months or less;
 - (b) 10% if the property has been held for more than 6 months but for 12 months or less; and
 - (c) 5% if the property has been held for more than 12 months but for 24 months or less.
9. ***The “date of acquisition” and “date of disposition” of a property are thus crucial concepts in determining whether SSD is payable for a resale transaction at all and if so, the rates of SSD applicable.*** For only if the property was “*acquired*” on or after 20 November 2010 would any subsequent resale of the property within a 24-month period trigger the application of the SSD in the first place. And the dates of “*acquisition*” and “*disposition*” of a

property will determine the length of the holding period and hence the rate of SSD applicable under the new Heads 1(1AA) and 1(1B) in the First Schedule of the Ordinance.

10. *Unfortunately, despite repeated calls for clarifications on the part of the Law Society and members of the profession, the meanings of the 2 important terms “acquired” and “disposed of” for the purpose of SSD remain unclear and the policy of the IRD in this regard has been inconsistent and confusing:*

- (a) When the Government first announced its policy on 19 November 2010, the IRD advised in its letter to The Law Society that *“the date on which the interest in the property is acquired under any enforceable instrument providing for the sale and purchase or other disposition of the property”* would be the *“date of acquisition”* of a property for the purpose of SSD. However, it went on to state that in practice, the *“date of acquisition”* would generally be *“the date of the formal agreement”*. In the words of the IRD:

“Subject to the drafting and passage of the amendment ordinance, the date of acquisition of a property is the date on which the interest in the property is acquired under any enforceable instrument providing for the sale and purchase or other disposition of the property. As a corollary, the date of disposal of a property is the date on which the interest in the property is disposed of under any enforceable instrument providing for the sale and purchase or other disposition of the property. In practice, such date(s) would generally be the date of the formal sale and purchase agreement.”

- (b) As contrary to what the IRD has stated, parties to a property transaction in Hong Kong would, as a matter of practice, enter into a *“binding and enforceable”* provisional agreement at the estate agent’s office before any formal agreement was signed, the Law Society sought clarifications from the IRD on the meanings of *“acquired”* and *“date of acquisition”* on 23 November 2010.
- (c) The IRD replied on 26 November 2010 and elaborated on the meaning of *“acquire”*. This time, reference is made to a *“specifically enforceable agreement”* and the IRD linked that term with the existence of an express clause providing for specific performance in the agreement. The relevant

part of the IRD's reply reads:

“a person “acquires” a property if he enters into a specifically enforceable agreement with a seller to transfer the property, not one that allows the seller to renege on a return of the deposit with/without compensation. The reason is that under such a specifically enforceable agreement, the purchaser becomes the equitable owner of the purchased property. Hence, if there is no specific clause in the provisional agreement allowing the buyer a right to claim specific performance from the seller, it is not a binding agreement for the purpose of the SSD.”

- (d) It was also noted that before the gazettal of the Bill on 3 December 2010, the IRD has provided the following guidance on the meanings of “acquire” and “dispose of” in the “Frequently Asked Questions” section on its website:

“Q6: For the purpose of SSD, how to define the date of purchase and sale of the property?

A: The relevant date is when the buyer and seller enter into a legally binding agreement for sale and purchase, i.e. the date on which the purchaser acquires or the seller disposes an interest in the property. Normally, it is the date of the formal agreement for sale and purchase. If it is provided in the provisional agreement that legal action would be instituted against the party not completing the transaction, the date of provisional agreement may be regarded as the date of purchase and sale of the property

- (e) The IRD's 26 November reply and the information provided on its website before the gazettal of the Bill tend to suggest that a provisional agreement is not binding for the purpose of SSD unless it contains an “express term” providing a right to seek for specific performance by the parties. However, the Committee submits that this is a misconception of law. Specific performance is an equitable remedy to be granted at the discretion of the court and the court would always entertain an application for such remedy against the defaulting party irrespective of whether there is any express provision for specific performance in the agreement provided that the agreement has not expressly excluded the parties from claiming that

remedy. The Law Society thus sought further clarifications on this from the IRD on 1 December 2010.

- (f) The Bill was gazetted on 3 December 2010; it seeks to provide a different test for determining whether one has “*acquired*” or “*disposed of*” a property, i.e. by reference to whether “*equitable ownership or legal ownership of the property is passed to the person (whichever first occurs)*”. However, no definition of “*equitable ownership*” was provided.
- (g) At the briefing session conducted by the Administration on the Bill on 3 December 2010, The Law Society reiterated the legal position to the Administration, as set out in its 1 December 2010 letter, i.e. that an express clause referring to specific performance is not required to make an agreement “*specifically enforceable*”. In response to this and The Law Society’s letter dated 1 December 2010, the Administration replied on 10 December 2010 as follows:

“For the purpose of the proposed SSD, a person “acquires” any residential property when equitable ownership or legal ownership of the property is passed to the person (whichever occurs first). The Stamp Office takes the view that a person “acquires” a property if he enters into a specifically enforceable agreement with a seller for the sale or purchase of that property. A specifically enforceable agreement is one that the parties thereto may rely on it to apply to the court for specific performance to compel the other party to sell / purchase the property. Specific performance is a discretionary remedy and it will not be granted if it is considered that compensation would be an adequate remedy. Therefore, whether a provisional agreement is a specifically enforceable agreement in respect of the sale or purchase of the property or not depends on the terms stated in the agreement.”

- (h) Whilst it first appeared to The Law Society from the above reply of the IRD on 10 December 2010 that the IRD has accepted that a specific clause referring to specific performance was not really required to make an agreement specifically enforceable, it was observed that following the gazettal of the Bill, the IRD has revised its guidance notes on the meanings of “*date of acquisition*” and the “*date of disposal*” of a property in the FAQ section on its website, essentially reiterating that an express specific

performance clause is needed to render a provisional agreement a specifically enforceable agreement for the purpose of SSD. Such guidance note, which is stated to be updated as of 16 December 2010, reads as follows:

Q6: For the purpose of SSD, how to define the date of acquisition and the date of disposal of a property?

A: The date of acquisition is the date on which the purchaser acquires the equitable ownership or legal ownership of a property, whichever is earlier. As a corollary, the date of disposal is the date on which the seller disposes of the equitable ownership or legal ownership of a property, whichever is earlier. Normally, it is the date of the formal agreement for sale and purchase. However, if it is provided in a provisional agreement that the buyer has the right to claim for specific performance in the event of defaults by the seller, the equitable ownership of the property passes under the agreement. The date of provisional agreement may thus be regarded as the date of acquisition and disposal of the property.

11. The Committee does not think the Bill has helped to clarify the meaning of “acquires” or “disposes of” any better by making reference to “*the passing of equitable or legal ownership*”. No definition of the term “*equitable ownership*” is provided in the Bill and the Committee does not think it reflects the IRD’s understanding of the term as stated on its website, if it is so intended. The Committee also queries the use of this term when Section 26 of the Ordinance and the Conveyancing and Property Ordinance (Cap. 219) respectively refer to the terms “*equitable estate or interest*” and “*equitable interest*”.
12. The Committee could not appreciate the rationale behind the IRD’s policy to differentiate between provisional and formal agreement or specifically enforceable and not specifically enforceable agreement when it comes to payment of SSD. The references to “*specific performance*” and “*specifically enforceable agreement*” have been very confusing to the public when an agreement without any express specific performance right does not necessarily mean the court will not grant such remedy and on the other hand, the right to seek for specific performance under an express provision in an agreement could be lost for some reasons.

13. The Committee noted that as an anti-avoidance measure, AVSD is chargeable on any agreement for sale under Section 29A(2) even if the agreement is “unenforceable, conditional, temporary or provisional”. Considering that the spirit of the legislation is to curb short-term speculation, it is unclear why the fact that an agreement is not specifically enforceable will render the vendor to be any less speculative. *To avoid unnecessary legal disputes in the future, the Committee submits that it is essential that the new legislation should clearly define when a person has “acquired” and “disposed of” his property for the purpose of SSD. For the sake of certainty, the Committee proposes that the date of any agreement signed between the parties for the sale and purchase of immovable property, whether provisional or formal, be taken as the date of “acquisition” and “disposal” of a property.*

Scope of Application of SSD and the Exemption Provisions

14. The Bill provides that the following cases be exempted from payment of SSD:
- (a) Nomination of a close relative (parent, spouse or child) to take up the assignment of a property under a sale and purchase agreement
 - (b) Sale or transfer of a property to close relatives (parent, spouse or child)
 - (c) Sale or transfer of a property due to bankruptcy or involuntary winding up (i.e. a company which is being wound up by the court under section 177(1) of the Companies Ordinance because it is unable to pay its debts)
 - (d) Sale or transfer of a property between associated companies; and
 - (e) Sale or transfer of a property to the Government.
15. *The Committee would like to seek clarifications on the application of SSD to the following areas:*
- (a) Conditional Agreements;
 - (b) Supplemental Agreement or Confirmatory Assignment [Query: would the date of these documents or the original document be taken as the date of acquisition or disposition of the property?]
 - (c) All kinds of enforcements actions by a Mortgagee in a mortgagor default situation including sale by mortgagee in possession, receiver sale or foreclosure order (with the subsequent sale pursuant to foreclosure order), equitable mortgagee’s right to subsell under equitable mortgages, etc.;
 - (d) Court Order for the Sale of Properties;
 - (e) Sale of Properties under a Compulsory Sale Order granted under the Land (Compulsory Sale for Redevelopment) Ordinance, Cap. 545;
 - (f) Divorce Cases [Query: would transfer of properties between the divorced

parties under a court order in the divorce proceedings be exempted under the “close relatives” exemption?]

(g) Acquisition of property under a will, the law of intestacy or right of survivorship.

16. The Bill provides in the new Section 29DA(8) that for a stamp duty payer who inherits a residential property from a deceased relative and disposes of it later, the date of acquisition for the purpose of SSD will be the date the deceased relative acquired the property. *The Committee would like to ascertain whether the same principle will apply to other exemption scenarios.*

Liability of Purchasers on Payment of Additional SSD Assessed by the IRD

17. The Bill provides that the amount of SSD payable is based on the stated consideration for the transaction *or the market value of the property as assessed by the Collector of Stamp Revenue, whichever is the higher* and that both the vendor and the purchaser will be held jointly and severally liable for payment of the SSD.
18. Whilst this is no different from the AVSD situation, this would work unduly harsh on the purchaser so far as SSD is concerned. Any person who fails to pay the SSD by the deadline for payment will be liable to penalties up to 10 times the amount of the SSD payable and evasion of SSD by fraudulent practices shall be a criminal offence. Under Section 15(1) of the Ordinance, i.e. any chargeable instrument which is not duly stamped is not admissible in evidence in any proceedings. Moreover, an instrument which has not been duly stamped will not be accepted for registration and this could affect the title of the property.
19. The Committee does not think the law in aiming to curb short term speculation by the “*vendor*” in a resale situation should penalize the purchaser. Solicitors will not be able to insert appropriate clauses for the protection of their purchaser client in the formal agreement if such provisions have not been included in the provisional agreement in the first place. Even if there are such provisions in the provisional agreement, they could hardly assist the purchaser should additional SSD be assessed by the IRD on a future date to the payable; it is very unlikely that the vendor could be traceable. Nor can the purchasers protect themselves by lodging the document with the IRD for adjudication of stamp duty given that the adjudication process would take time but the purchasers are subject to a time limit for registration in order for the transaction to gain priority.

20. *The Committee submits that to be fair to the purchaser, if he is to be made liable for payment of SSD at all, (1) his liability to pay SSD should be limited to the stated consideration in the document; and (2) for conveyancing purpose, document stamped up to the stated consideration in the document should be deemed to have been duly stamped for all purposes save and except the vendor's personal liability to pay the additional SSD; and (3) there should be a time limit on the stamp duty adjudication process.*

Retrospective Effect of the Legislation

21. Under Clause 1 of the Bill, most of the proposed amendments relating to SSD will come into operation retrospectively from 20 November 2010. Some provisions, including the need for the document to contain further particulars of the Property for the purpose of SSD, will be operative as from 3 December 2010.
22. Besides the question of the constitutionality of making the SSD legislation retrospective, *the Committee has grave reservation as to whether it is appropriate, as a matter of policy, for SSD to apply to resale transactions retrospectively, considering the confusion to the market on the exact meanings of such important concepts as "acquired" and "dispose of" since the announcement of SSD policy on 19 November 2010.*
23. *The Committee also has concern on the requirement for the parties to insert further particulars in the agreement/ assignment for the purpose of SSD under Section 11(1) of the Stamp Duty Ordinance retrospectively as from 3 December 2010.* Such further particulars include:
- (a) whether the property is "*acquired*" on or after 20 November 2010;
 - (b) "*date of acquisition*" and under what instrument;
 - (c) "*date of disposal*" and under what instrument; and
 - (d) "*holding period*" before "*disposal*".

Besides the fact that it will not be possible for the parties to do so given the present uncertainty in the interpretation of the terms "*acquire*" and "*dispose of*", there is also a lack of the legal basis for such requirement for the further particulars to be included in the relevant document "*now*" short of enactment of legislation.

24. The IRD has prepared a draft revised Stamping Request Form requiring the further particulars as listed in the preceding paragraph to be inserted for SSD

purpose for The Law Society's comments. This form would need to be submitted to the IRD at the time of stamping of the document. Whilst the form is usually completed by the purchasers or their solicitors, they will not be in a position to ascertain the date of "*acquisition*" of a property by the vendors when normally, only the formal agreement but not the provisional agreement would be registered and the vendor was not obliged or may not be able to produce the provisional agreement to prove his title to the property. Depending on the definitions of "*acquired*" and "*dispose of*" to be ultimately agreed upon, the purchasers and their solicitors may not be in a position to determine when the vendor has "*acquired*" the property.

Series of Transaction

25. Under the proposed Section 29DA(3) of the Ordinance, if only part of the residential property is acquired within the 24-month period, SSD is chargeable only by reference to that part.

26. In cases where a person resold several properties to a person under one transaction with only some but not all of these properties being acquired within a 24-month period, there would seem to be a need for SSD purpose for the parties to apportion the sale price. However, it could pose problem to the parties and their solicitors; a Valuation report might be called for but this as well as the IRD's adjudication process would both take time.

**The Law Society of Hong Kong
The Property Committee
4 January 2011**