

## CHAPTER 4

# Fixed and Ad Valorem Duties and An Overview of the Heads of Charge

### 1. Fixed and ad valorem duties

[23]

The Ordinance imposes two distinct types of duty, namely (1) fixed duty and (2) ad valorem duty. Fixed duty does not depend upon the consideration expressed in the instrument or the value of the property transferred by the instrument (eg under head 2(4) of the First Schedule transfers of Hong Kong stock where no beneficial interest in the stock passes are only subject to duty of \$5). Conversely, ad valorem duty varies according to the consideration expressed in the instrument or the value of the property transferred by the instrument (eg under head 2(1) of the First Schedule, contract notes for the sale and purchase of Hong Kong stock are liable in total to duty of \$2.50 per \$1,000 of the amount or value of the consideration provided).

### 2. The basic structure of the Ordinance

[24]

The basic structure of the Ordinance is best understood by examining the terms of, and inter-relationship between, section 2(1), section 4 and the First Schedule. Section 2(1) sets out the basic definitions applicable for the purposes of the Ordinance. They are of crucial importance. It should also be appreciated that the definitions contained in section 3 of the Interpretation and General Clauses Ordinance are equally important. Not only does this section set out definitions for general words and phrases contained in the Ordinance, but also certain crucial terms such as 'immovable property' – which forms the subject matter of the charge imposed by head 1 of the First Schedule to the Ordinance – are specifically defined.

### 3. The general charging provision

[25]

The general charging provision imposing stamp duty is set out in section 4(1). That section expressly states that it is only those instruments specified in the First Schedule which are subject to stamp duty 'and that the headings, notes and explanations in that Schedule shall have effect

accordingly'. The combined effect of these provisions is to (1) impose liability for duty on specified instruments, (2) set time limits within which those instruments must be stamped and (3) specify the person or persons liable to pay the duty.

[26]

The heads of charge, which are contained in the First Schedule, are set out below.

### 4. Head 1: Immovable property in Hong Kong

[27]

The following instruments are subject to duty.

#### a. Head 1(1): Conveyance on sale

[28]

The crucial definitions of 'conveyance' and 'conveyance on sale' are contained in section 2(1); 'immovable property' and 'property' are both defined in section 3 of the Interpretation and General Clauses Ordinance. The duty is ad valorem and the maximum rate is 3.75% of the amount or value of the consideration provided for the conveyance. Essentially, this head covers virtually all instruments which convey a beneficial interest in land in Hong Kong. A fixed rate of duty of \$100 applies to a conveyance executed in conformity with a chargeable agreement for sale of residential property which is subject to the provisions of Part IIIA and head 1(1A) of the Ordinance.

#### b. Head 1(1A): Agreement for sale

[29]

Terms such as 'agreement for sale', 'unwritten sale agreement' and 'non-residential property' are defined in section 29A(1). The duty is ad valorem and imposed at the same rate as for a conveyance on sale under head 1(1). Subject to a maximum deferral period of three years, in the case of an agreement for sale of residential property to an end user (as distinct from a person who resells the property before the conveyance), the payment of head 1(1A) duty can, on application to the Collector, be deferred until 30 days after the execution of the conveyance. Where an agreement is stamped at ad valorem rates under head 1(1A), any conveyance executed in conformity therewith is only liable to a fixed duty of \$100. This head covers all agreements for sale under which a beneficial interest passes in residential property in Hong Kong. Head 1(1A) should be read together with Part IIIA which contains all of the necessary interpretation and machinery provisions relating to stamping agreements for sale of residential property.

c. *Head 1(2): Lease*

[30]

'Lease' is defined, unhelpfully, in section 2(1). The duty is ad valorem. Any premium paid for the grant of the lease is dutiable in accordance with conveyance on sale rates under head 1(1); any rent is dutiable in accordance with rates dependent upon the term of the lease (maximum 1% of the average yearly rent). It is only leases of 'immovable property' which are subject to duty.

5. **Head 2: Hong Kong stock**

[31]

The following instruments are subject to duty.

a. *Head 2(1): Contract note for the sale or purchase of any Hong Kong stock*

[32]

'Contract note', 'stock' and 'Hong Kong stock' are all defined in section 2(1); 'sale or purchase' is defined in section 19(16). The duty is ad valorem and in total is 0.25% (\$2.50 per \$1,000) of the amount or value of the consideration provided. The definition of 'stock' is extremely broad. The most common situations to which this head applies involve the sale and purchase of shares in Hong Kong companies, covered warrants relating to shares in Hong Kong companies and units in unit trusts maintaining a register in Hong Kong.

b. *Head 2(2): Contract note in respect of jobbing business*

[33]

This head is currently of limited relevance. Jobbing business has not developed significantly in Hong Kong (see [195]).

c. *Head 2(3): Transfer operating as a voluntary disposition*

[34]

'Transfer' is not defined in section 2(1) although 'instrument of transfer' is. The same ad valorem duty as that imposed upon contract notes, 0.25%, (plus a fixed duty of \$5) is charged on the transfer by reference to the value of the stock transferred. The most common case covered by this head is a transfer of Hong Kong stock (typically shares in Hong Kong companies) for nil or inadequate consideration.

d. *Head 2(4): Transfer of any other kind*

[35]

This head covers all transfers of Hong Kong stock to which head 2(3) does not apply – ie transfers under which no beneficial interest

passes (eg a transfer under a will from an executor to a legatee entitled to a specific devise). A fixed rate of duty, \$5, is charged on the transfer.

6. **Head 3: Hong Kong bearer instruments**

[36]

'Bearer instrument' (one whereby ownership of stock is transferred by mere delivery plus intention) and 'Hong Kong bearer instrument' (a bearer instrument issued in Hong Kong, or outside Hong Kong by or on behalf of a Hong Kong entity) are both defined fairly narrowly in section 2(1). Basically, this head affects certain capital market transactions, particularly the issue of share and other stock warrants. However, in view of (1) the important exclusion from duty for bearer instruments issued in respect of 'loan capital' (defined in section 2(1)) and (2) the high rate of ad valorem duty (3% of the value of the stock as at the date of issue), in practice the charge is usually avoided.

7. **Head 4: Duplicates and counterparts**

[37]

There are many occasions in commercial and conveyancing practice where an original document is executed and lodged at the Stamp Office for stamping and, at the same time, a duplicate (or copy) or a counterpart is prepared and executed for retention by one of the parties. Examples of instruments chargeable under this head are as follows.

- (1) A grant of a lease executed by the lessor is stampable at the appropriate rate of duty set out in head 1(2). The counterpart of the lease, executed by the lessee, is stampable under head 4 and the appropriate amount of duty paid on the lease is denoted thereon; and
- (2) A deed of exchange entered into between A and B for an exchange of (non-residential) immovable property is stampable, in accordance with section 25(7), at head 1(1) rates to the extent of any equality money paid or given for the exchange. A duplicate deed, which will be executed for retention by one of the parties, is stampable under head 4 and the appropriate amount of duty paid on the original is denoted thereon.

Liability to duty under head 4 is minimal – it cannot exceed \$5. In this regard, however, our emphasis is to stress the importance of correct stamping and not the amount of duty imposed.

(ii) *Background and scope of charge*

[203]

The history of gradual amendment to head 3 of the First Schedule reveals a continuous restriction of the scope of this head of charge. When the Ordinance was revised in 1981, bearer instrument duty was provided in head 3. This was amended later in 1981 to exclude instruments relating to stock which consisted of loans expressed in currencies other than Hong Kong dollars. The change was made to encourage the development of Hong Kong as a financial centre.

[204]

With effect from 1 April 1986 bearer instrument duty was further modified to exempt Hong Kong dollar loan instruments. Accordingly, from this date bearer instrument duty only applied to Hong Kong bearer instruments issued in respect of any stock *other than* any loan capital or units in a loan capital unit trust scheme. Given the wide definition of loan capital (section 2(1)) and the restricted definition of Hong Kong bearer instrument (see [202]) duty is rarely applicable. In practice such Hong Kong dollar bearer instruments as exist are practically all issued offshore in order to avoid stamp duty. The result has been that head 3 has raised very little revenue. Its only real effect has been to discourage onshore issues to the detriment of Hong Kong as a financial centre. The only significant financial instrument caught by head 3 is a share warrant issued in Hong Kong in bearer form. As the practical scope of the charge is narrow, those involved in advising upon the issue of bearer instruments tend to be specialists in the securities field.

(iii) *Rate of duty*

[205]

Head 3 imposes the highest rate of stamp duty in the Ordinance - 3% of the market value of a Hong Kong bearer instrument on issue. Any such instrument should be stamped before issue. After issue, no further duty is payable as the nature of a bearer instrument is that it can be transferred without bringing into existence any further document.

CHAPTER 16

**Exemptions and Reliefs**

[206]

The various exemptions and reliefs from stamp duty are contained in Part V of the Ordinance. Only a summary of salient points appears below.

**1. General exemptions – section 39**

[207]

The following general exemptions from duty are contained in section 39.

- (a) All instruments duly stamped under the stamp regulations enforced by the Japanese in Hong Kong during the Second World War.
- (b) All conveyances on sale, and agreements for sale of residential property (section 29H(1)(a)), to the Government or an incorporated public officer.
- (c) All grants by the Government and all Government leases and all surrenders of such grants and leases.
- (d) All instruments executed by the Housing Authority for the purposes of the Housing Ordinance (Cap 283 LHK), including agreements for sale of residential property, other than a conveyance on sale for the purposes of section 17A thereof.
- (e) All instruments executed by the Urban and Regional Councils for the purposes of the Urban Council Ordinance (Cap 101 LHK) and the Regional Council Ordinance (Cap 385 LHK).
- (f) All conveyances on sale, and agreements for sale of residential property, of exempted premises to an exempted person.
- (g) All instruments exempted under section 125 of the Bankruptcy Ordinance or section 281 of the Companies Ordinance.

**2. Instruments specially exempted – section 40**

[208]

A special exemption is given for all instruments in respect of which no person is liable for duty, provided it is presented to the Collector for stamping.

### 3. Persons exempted from duty – section 41

[209]

Section 41 provides that neither the Hong Kong Government nor various public officers are liable for the payment of stamp duty. In such cases where a person is specifically exempted from duty, the burden of paying duty on a chargeable instrument falls upon any non-exempt party to the instrument.

### 4. Miscellaneous reliefs

[210]

The Ordinance also provides for the following miscellaneous reliefs.

- (a) Reduction of duty in respect of certain leases to which the government is a party (section 42).
- (b) Exemption and reduction of duty in respect of certain leases of consular and quasi-consular premises (section 43).
- (c) Exemption for gifts of immovable property or Hong Kong stock to charitable institutions or trusts of a public character (section 44).
- (d) Exemption for certain (1) instruments effecting the transfer of a beneficial interest in immovable property or Hong Kong stock and (2) contract notes in respect of the sale and purchase of Hong Kong stock, from one associated body corporate to another. The test for association is so strict that transfer of the relevant property amounts to little more than a change of nominal ownership: a 90% control or common ownership of issued shares is required. This exemption is contained in section 45. It is extremely important, contains complex anti-avoidance provisions and reference should, therefore, be made to [211] et seq below.
- (e) Exemption for instruments affecting immovable property made for new Government leases or exchanges (section 46).
- (f) Exemption for instruments confirmatory of transactions during the Japanese occupation of Hong Kong in the Second World War (section 47).
- (g) Exemptions applying to certain voluntary dispositions (sections 27(5) and 29F; see also [153] and [196]).

### 5. Relief for dispositions between associated corporations

[211]

Section 45, as expanded by section 29H(3), provides an exemption for dispositions between associated corporations. The exemption applies to conveyances of immovable property, agreements for the sale and purchase of residential property and contract notes and transfers relating to Hong Kong stock. The section therefore exempts from duty intra-group agreements for the sale of residential property and conveyances of

beneficial interests in immovable property, transfers of Hong Kong stock and contract notes relating to the sale or purchase of Hong Kong stock. Anomalously it does not apply to grants of leases unless the lease takes effect as a voluntary disposition. It is not necessary that either or both the transferor and transferee are incorporated in Hong Kong for the exemption to apply. There is no Hong Kong equivalent to the United Kingdom relief for instruments used in connection with schemes for reconstruction or amalgamation of companies.

[212]

The section is subject to detailed anti-avoidance provisions designed to ensure that relief is not obtained in circumstances in which the real purpose of a disposition is to convey immovable property or to transfer shares free of stamp duty to a corporation which is not a member of the group. The following conditions must be satisfied if the relief is to apply:

- (1) The effect of the relevant instrument must be to convey or transfer a beneficial interest in immovable property or Hong Kong stock from one body corporate to another. The exemption does not apply where an individual conveys or transfers property to a company which he owns.
- (2) The bodies corporate must be associated, that is to say, either:
  - (a) one of the bodies must be the beneficial owner of not less than 90% of the issued share capital of the other; or
  - (b) a third party must be the beneficial owner of not less than 90% of the issued share capital of each.It is not sufficient that the shares in the relevant companies are owned by the same individual. Ownership, which must be beneficial, may, however, be direct or through other bodies corporate, or partly direct and partly through other bodies corporate. The rules for determining the proportion of share capital held directly and indirectly for the purposes of intra-group transfers are contained in the Third Schedule. For example, if A Ltd owns 95% of the issued capital of B Ltd which owns 91% of the issued capital of C Ltd, A Ltd owns only 86.4% of C Ltd and section 45 relief is not available between A Ltd and C Ltd, although it is available between A Ltd and B Ltd and between B Ltd and C Ltd.
- (3) The relevant instrument must not have been executed 'in connection with an arrangement' under which:
  - (a) any part of the consideration was to be provided or received directly or indirectly by a person other than an associated corporation of the transferor or the transferee; or
  - (b) the beneficial interest in the immovable property or Hong Kong stock was previously transferred directly or indirectly by a person other than an associated body corporate of the transferor or the transferee; or
  - (c) the transferor and the transferee were to cease to be associated by reason of a change in the percentage of the issued share