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# Hong Kong's Proposed New Tax of Special Stamp Duty for Residential Properties and its Ramifications

## The Announcement

On 19 November 2010 the Government announced the proposal to introduce a new tax of Special Stamp Duty ("**SSD**"), which will be payable in addition to the usual *ad valorem* stamp duty payable on transfer of Hong Kong residential properties.

At this moment, the Government is still preparing the bill to introduce the amendments of law for passing by the Legislative Council. The exact scope and legislative definitions of terms for SSD are therefore not yet available. The information provided in this article is principally based on the information available from the website of the Inland Revenue Department, the correspondence exchanged between The Law Society of Hong Kong and the Inland Revenue Department and our enquiries made with the Stamp Office.

## When is Payment Triggered

SSD will be payable where the following conditions are met:

1. The transaction involves a residential property ("**Property**");
2. The Property was acquired by the seller on or after 20 November 2010 ( "**Acquisition**"); and
3. The Property was sold by the seller ("**Disposal**"), and such Disposal occurs within 24 months of the date of Acquisition.

The seller and the buyer are jointly and severally liable for paying the SSD.

The SSD payable will be calculated as a certain percentage of the value of the Property ("**Value**") (being the higher of the stated consideration of the Disposal or the market value of the Property at the time of the Disposal) according to the length of time between the date of Acquisition and the date of Disposal ("**Holding Period**") on a sliding scale:

1. Holding Period is 6 months or less: **15% of the Value**;
2. Holding Period is more than 6 months but for 12 months or less: **10% of the Value**;
3. Holding Period is more than 12 months but for 24 months or less: **5% of the Value**.

If the Holding Period is more than 24 months, no SSD will be payable.

## Our Concerns

We consider that the implementation of SSD may lead to a number of legal issues, which will need to be considered by the Government, Legislative Council and other interested parties. This legal update considers some of the legal issues.

## Background to SSD

On 18 November 2010 an International Monetary Fund report identified the need for Hong Kong to take steps to redress the problem of speculation in the residential property market (or otherwise risk a serious price correction).

On 19 November 2010, the government proposed and implemented various measures to reduce speculation in Hong Kong's residential housing market and to reduce the pressure on this market created by excessive liquidity.

Amongst these measures was the announcement of SSD and an announcement that deferral of payment of *ad valorem* stamp duty will no longer be available for residential properties (and stamp duty and SSD must be paid within 30 days in all cases). An announcement by the Hong Kong Mortgage Corporation and the Hong Kong Monetary Authority on the same day also reduced immediately the permitted level of mortgages by banks and the ambit of the Mortgage Insurance Programmes scheme. These issues will not be discussed in this legal update.

This legal update focuses on the imposition of the SSD. The payment of SSD will be in addition to *ad valorem* stamp duty which will continue to be charged at the usual rates (the highest band being 4.25%). The maximum stamp duty (including SSD) is thus 19.25%. Penalties for late payment will result in a maximum penalty of 10 times the original duty (i.e. 192.5% of the Value).

SSD is a joint and several liability of the seller and purchasers and avoidance will result in criminal liabilities.

## Proposed Exemptions

Exemptions for the SSD are proposed for the following cases:

1. Nomination of a close relative to take up the assignment of a Property under a sale and purchase agreement ("close relative" means parent, spouse or child);
2. Sale or transfer of a Property to close relatives;
3. Sale or transfer of a Property due to bankruptcy/involuntary winding up;
4. Sale or transfer of a Property between associated companies; and
5. Sale or transfer of a Property to Government.

## Particular Concerns with the Proposed Legislation

The draft legislation is not yet gazetted by the Government.

From the limited information available so far, we have identified a number of issues that must be addressed.

### (1) OBLIGATION TO PAY SSD

Whilst a seller will know when he or she purchased a Property (and thus whether SSD should be payable), a buyer may not have this information when he signs an agreement with the seller for the purchase of the Property.

The market practice in Hong Kong is to enter into a legally binding provisional agreement for sale and purchase ("**PASP**") and to subsequently enter into a formal agreement for sale and purchase ("**ASP**") which supersedes the PASP. However, if the PASP is a mutually binding agreement giving either party the right to specific performance, then the parties are obliged to complete the sale and purchase irrespective of whether there is an ASP.

Payment of SSD will be a joint and several liability for the seller and the purchaser who bought from the seller upon the Disposal of the Property by the seller.

Yet it is ultimately the purchaser who is most concerned to ensure that both (i) the usual *ad valorem* stamp duty, and (ii) the SSD are paid, before he can register the PASP or ASP (or the ultimate assignment in his favour) at the Land Registry, in order to protect his or her priority and interests in the Property.

This is likely to cause problems in practice as the PASP is usually signed before the solicitors become involved. Therefore, a purchaser may not be legally advised as to whether SSD is payable upon a sale; and then, if it turns out that SSD is payable, dispute will arise as to who should bear the SSD. Usually, the PASP will merely state that all stamp duty is to be borne by the purchaser. Therefore, the purchaser will be put in a very disadvantageous position, and may be contractually required to make payment of the SSD.

Hence, SSD could be a trap for an unwary purchaser.

On the other hand, if the seller is to bear the SSD, the seller may be required to set aside a substantial amount of cash to meet payment of the SSD on the PASP or the ASP upon the Disposal. If the seller has financial difficulty in meeting such payment, the seller and the buyer may have to consider whether the buyer should pay the SSD, in which case this may need to be reflected in the purchase price.

The public should be wary of the risks involved. Suitable guidelines should be given to estate agents by the Estate Agent Authority or the Stamp Office or other relevant governmental departments as to how these different situations should be handled.

### (2) MEANING OF "DATE OF ACQUISITION" AND "ACQUISITION" OF PROPERTY

The date of Acquisition is important in determining:

- whether an acquisition occurred before or after 20 November 2010 and thus whether the subsequent disposal is subject to SSD at all; and
- the length of the Holding Period and hence the amount of SSD payable.

The Law Society of Hong Kong has written to IRD to seek clarification on the meaning of 'acquisition'. IRD still needs to clarify the exact meaning of 'acquisition' and 'date of acquisition' of Property, as there are several forms of PASP commonly used in Hong Kong.

### (3) SSD FROM THE POINT OF VIEW OF MORTGAGEES

Since the bill for the amendment ordinance has not yet been gazetted, it is not yet known what impact of the SSD will be on mortgagees banks or other financial institutions.

SSD may impact on a mortgagee, in a mortgagor default situation, where:

- it forecloses on a mortgage;
- it obtains an assignment of a Property (whether in the name of the mortgagor, or the mortgagee or the mortgagee's nominee) mortgaged to it by a purchaser under an equitable mortgage of a Property in an uncompleted development;
- it exercises power to sub-sell under such an equitable mortgage;
- it appoints a receiver to sell as agent of the mortgagor whether under the aforesaid equitable mortgage or under a normal legal mortgage of a Property in a completed development;

and the mortgagee exercising its powers under the mortgage.

If SSD is not exempted in such circumstances, the sales proceeds realised by the mortgagee may be reduced by the amount of SSD payable by it. This will prejudice the interests of the mortgagee banks/ financial institutions and increase the financial burden for the mortgagor (when the net sales proceeds do not cover the loan).

It is noted that a sale or transfer of a property due to **bankruptcy** or **involuntary winding up** are proposed exemptions from SSD, it is logical that exemptions should also be granted to cases where a mortgagee exercises its power of sale or appoints a receiver to sell under a mortgage or resell the property after foreclosure.

Other financial issues may arise from SSD in so far as mortgagees are concerned and it is hoped that the government will consult the Hong Kong Association of Banks on the draft legislation.

### (4) COMPULSORY SALE ORDERS

Particular considerations should be given to cases where the owners of a building are forced to sell their Properties under an order for compulsory sale granted under the Land (Compulsory Sale For Redevelopment) Ordinance (Cap. 545).

As such owners are forced to sell, it does not seem fair for these owners to be subject to SSD.

On the other hand, if the SSD is to be made payable by a successful bidder of the entire building or lot, the SSD may be reflected in the sale price. In such a case, the sale price obtainable in the auction (and which will be distributed to all the owners) will be reduced. This is again not fair to the owners of the building.

A proposed solution is that exemption should be granted to sales under a compulsory sale orders.

### (5) OTHER SITUATIONS

The above are just some examples of the implications of SSD. Further study of the draft legislation may reveal other situations that need attention.

### (6) RULE OF LAW

It is important to understand that at this moment there is no law on the proposed SSD (and cancellation of deferral of payment of stamp duty).

The government is still preparing the bill to be passed by the Legislative Council. Given that SSD is an entirely new tax, and there are many facets to it, the legislation could be fairly lengthy and complicated and is likely to take some time. The amendment ordinance (once passed) will have retrospective effect from 20 November 2010.

Yet, during the interim period, the whole legal profession, estate agents and every landowner and purchaser in Hong Kong society will need to comply as if an amendment ordinance has already been passed.

This state of affairs is highly unusual and countries with common law systems generally resist laws with retrospective effect.

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