



Inland Revenue Department

The Government of the Hong Kong Special Administrative Region
of the People's Republic of China

STAMP OFFICE INTERPRETATION AND PRACTICE NOTES

NO. 2 (REVISED)

**RELIEF FOR STOCK BORROWING
AND LENDING TRANSACTIONS**

These notes are issued for the information of duty payers and their authorized representatives. They contain the Department's interpretation and practices in relation to the law as it stood at the date of publication. Duty payers are reminded that their right of appeal to the Court is not affected by the application of these notes.

These notes replace those issued in February 2011.

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March 2023

Our web site : www.ird.gov.hk

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INTRODUCTION

The scope of stamp duty relief for stock borrowing and lending transactions under the Stamp Duty Ordinance, Cap. 117 (the SDO), (the Relief) was extended by the Stamp Duty (Amendment) (No. 2) Ordinance 1994, the Stamp Duty (Amendment) (No. 2) Ordinance 1998 and the Revenue Ordinance 1999. The relevant amendments were made to simplify the operations of the stock borrowing and lending relief regime. Since then, the Collector of Stamp Revenue (the Collector) has revised certain practices in response to feedbacks from the participants in the stock borrowing and lending market and legal advice obtained by the Department. They include allowing a single registration of an agency stock loan agreement where the lender acts as both a principal and an agent (see paragraph 48).

2. These Practice Notes set out a summary of the interpretation of the Collector in respect of the provisions on the Relief, and provide details of the Department's practices in implementing them. The Practice Notes focus on the stock borrowing and stock return transactions effected directly between a lender and a borrower pursuant to a stock borrowing and lending agreement executed between them (*i.e. the commercial stock loans*).

THE RELIEF

3. In essence, section 19(1) of the SDO provides that any person who effects a sale or a purchase of Hong Kong stock shall forthwith make and execute a contract note and have it stamped. As the term "sale or purchase" includes any disposal or acquisition, other than an allotment, for valuable consideration, stock borrowing and lending transactions, unless provided otherwise, would be subject to stamp duty. However, by virtue of section 19(11), where specified conditions are satisfied, the parties to stock borrowings (see paragraph 4) and stock returns (see paragraph 26) made under a stock borrowing and lending agreement (see paragraph 8) are not required to prepare contract notes and pay stamp duty.

Stock borrowing

4. A "stock borrowing" is the obtaining of Hong Kong stock by a borrower from a lender under a stock borrowing and lending agreement, whether the stock is obtained:-

- directly from the lender; or
- indirectly under or through a recognized clearing house and in accordance with the rules of that clearing house.

5. Only Hong Kong stock the sale and purchase of which are subject to the rules and practices of The Stock Exchange of Hong Kong Limited (SEHK) is eligible for the Relief. In other words, all stocks listed on the SEHK qualify for the Relief. On the other hand, shares in private companies do not fall within the scope of the Relief.

6. In order to obtain the Relief, the borrowed stocks are required to be used for one or more of the “specified purposes” as set out in section 19(16), failing which the stock borrowing will be deemed to be a sale and a purchase of the stocks both effected by the borrower by virtue of section 19(12)(b) (see paragraph 37 for the actions to be taken in such scenarios). Any subsequent return of stocks would not be a stock return qualifying for the Relief but would be treated as a sale and a purchase effected by the borrower and the lender respectively, which are subject to the preparation of contract notes and payment of stamp duty (see paragraph 27).

Borrower

7. A “borrower” is defined in section 19(16) as a person who is eligible to obtain Hong Kong stock under a stock borrowing and lending agreement. In the context of a commercial stock loan, any person can enter into a stock borrowing and lending agreement as a borrower.

Stock borrowing and lending agreement

8. A “stock borrowing and lending agreement” is defined in section 19(16) as an agreement which:-

- (a) contains provisions providing for:-
- obtaining stock by a borrower from a lender;
 - returning stock of the same quantity and description as the

borrowed stock, or the delivery of its “reasonable equivalent”, by the borrower to the lender (see paragraphs 28 – 31); and

- a “specified payment” to be made by the borrower to the lender or an arrangement which the Collector considers as a fair and proper alternative to making this payment; and

(b) does not, in the opinion of the Collector, reduce the lender’s risk of loss or opportunity for gain in respect of the borrowed stock.

9. A securities lending agreement satisfying the conditions under paragraph 8 may be registered with the Collector. A list of commonly used model agreements for securities lending that have been confirmed as meeting the conditions in paragraph 8, including model agreements published by the International Securities Lending Association (ISLA) and The Bond Market Association (TBMA), is available on the Department’s web site (www.ird.gov.hk)

Specified payment

10. Apart from containing provisions for obtaining and returning stock, a stock borrowing and lending agreement has to contain provisions requiring the borrower to make a “specified payment” to the lender [paragraph (a)(i)(C)(I) of the definition of “stock borrowing and lending agreement” in section 19(16)]. Specified payment, as defined under section 19(16), is a payment equivalent to the economic benefits which the lender would have received during the loan period as being the holder of the stock had the stock not been parted with him as a result of the stock borrowing. Provisions for payment of “manufactured dividends” under usual securities lending agreements or securities repurchase agreements would satisfy such requirement. In the case where no such provision is included in the agreement, the Collector may still accept the agreement to be registered as a stock borrowing and lending agreement if he is of the opinion that the agreement provides for an arrangement which can be regarded as a fair and proper alternative to the requirement to make the specified payment [paragraph (a)(i)(C)(II) of the definition of “stock borrowing and lending agreement”; see also paragraph 43].

11. The purpose of legislating the aforesaid requirement is to ensure that the lender would retain the risks and rewards associated with the borrowed stock. Hence, a provision in a securities lending agreement providing for the return by the borrower

to the lender of stock of the same quantity and description (or the delivery of the reasonable equivalent of the stock) in consideration of the return by the lender of the collateral previously given by the borrower will satisfy this requirement. In the context of a stock repurchase agreement (see paragraphs 40 – 43), the repurchase of stock by the seller at a predetermined price which is independent of the stock price at the time of repurchasing will also be considered as in line with this requirement.

Execution of the agreement

12. A stock borrowing and lending agreement may be executed by a duly authorized agent on behalf of the lender or the borrower, or both, as the case may be. There may also be joint borrowers under an agreement and where this is the case, the liabilities of the borrowers in respect of their obligations under the SDO are joint and several. See also paragraphs 46 – 48 for the treatment of agency stock loan agreements.

13. A composite stock borrowing and lending agreement may be executed between a single lender and a number of independent borrowers. In such a case the composite agreement will, in relation to each borrower, be treated as separate and distinct agreements and the prescribed registration fee will be payable on this basis. Each borrower will only be liable to comply with the requirements of the SDO in so far as the agreement relates to his own transactions.

Amendments to the agreement

14. In the event that a stock borrowing and lending agreement is amended, the Stamp Office must be informed of the relevant details if they change the agreement to the extent that in its amended form it could not be considered to be a “stock borrowing and lending agreement” under section 19(16) of the SDO. However, for amendments which do not have this effect (e.g. an amendment to the indemnification provisions), it will not usually be necessary to inform the Stamp Office. Nevertheless, the Collector reserves the right to call for the submission of full details of any amendments, either generally or in any particular case, should the circumstances so warrant.

Specified purposes

15. Under section 19(16), the term “specified purpose”, as it relates to the

borrowing of stock by any person (the borrower), means:-

- the settling of a sale of stock effected in Hong Kong or elsewhere by the borrower or another person;
- the settling of a future sale of stock, irrespective of whether or not the sale is agreed at the time when the borrowing is effected, by the borrower or another person;
- the replacement, either wholly or in part, of stock obtained by the borrower under another stock borrowing;
- the on-lending of the borrowed stock to another person who effects a stock borrowing in respect of the stock on-lent; or
- any other purpose authorized in writing by the Collector.

16. One of the purposes for which stock may be borrowed is to settle a sale of stock where the seller would not otherwise have the required amount of stock available for settlement, such as in a short sale. The Relief extends to sales effected off the SEHK, including those made in places outside Hong Kong. In addition, a sale need not be effected by the borrower as stock may be borrowed to settle a sale effected by a third party.

17. Stock may be borrowed in advance of a sale if it is anticipated that borrowed stock will be required for settlement of that sale. If the expected sale does not materialize and the person returns the borrowed stock to the lender, the return will be treated as a qualifying stock return. Future sales of stock may also be effected by persons other than the borrower. It should be noted, however, that if the borrowed stock has in fact been used for a non-specified purpose, the transaction will cease to qualify for the Relief and stamp duty will become payable on both the original borrowing transaction (see paragraph 37) and the return transaction (see paragraph 27), if any.

18. A lender may sometimes demand an early return of the borrowed stock. A borrower without a sufficient quantity of the stock demanded on hand can borrow further stock from a third party to repay the first lender. The replacement borrowing may be for the same quantity as the stock demanded or for a lesser quantity. A

condition applying to such an arrangement is that the initial borrowing must itself have been a stock borrowing within the meaning of the SDO.

19. A stock borrowing made by an intermediary for on-lending to another person who also effects a stock borrowing will qualify for the Relief. The Relief is only available where the subsequent borrower uses the stock borrowed for a specified purpose. Recognizing that an intermediary might have difficulties in ascertaining how the stock was put in use by the subsequent borrower, the Collector is prepared to look at an intermediary's borrowing and on-lending separately. Thus, provided an intermediary borrows stock for the purposes of on-lending, his borrowing transaction will qualify for the Relief. In other words, the failure of a subsequent borrower to use the borrowed stock for a specified purpose will not affect the Relief granted to an intermediary in respect of his borrowing. Furthermore, as stocks carrying the same rights are fungible, it is not necessary to match each of an intermediary's stock borrowings with each of his on-lending on a case-by-case basis. So long as all stocks borrowed by an intermediary are on-lent, the relevant transactions will qualify for the Relief.

20. The Collector is empowered to grant the Relief for purposes other than those specifically described in the definition of "specified purpose". Apart from the purposes of liquidity management in respect of stock repurchase or buy-sell transactions (see paragraphs 40 – 43), the Collector does not presently envisage any extension of the Relief.

Registration of stock borrowing and lending agreements

21. One of the conditions for obtaining the Relief is registration of the stock borrowing and lending agreement with the Collector. Section 19(12A) of the SDO stipulates that a stock borrowing and the related stock return will not qualify for the Relief unless:-

- an *executed copy* or a *true copy* of the stock borrowing and lending agreement under which the stock borrowing and stock return are provided for;
- the prescribed fee (currently \$270); and
- any other documents, particulars and information required by the Collector

are provided by the borrower to the Collector for registration at any time after the agreement is executed but *before the expiry of 30 days after* the stock borrowing is effected. For example, where a stock borrowing and lending agreement is executed on 1 April 2022 and a stock borrowing is done in pursuance of that agreement on 1 May 2022, the borrowing can qualify for the Relief so long as the agreement is registered on or before 31 May 2022. If the agreement is not so registered, no relief can be granted to the stock borrowing in question. However, that failure to register does not affect subsequent stock borrowings. If, say, another stock borrowing takes place on 15 June 2022, the borrowing (and any subsequent borrowings under the agreement) can still qualify for the Relief if the agreement is registered on or before 15 July 2022.

22. Section 19(12A) allows for the filing of a *true copy*, in lieu of an executed copy, of the agreement which is shown to the satisfaction of the Collector that it is a true copy of the original. For this purpose, a copy of the agreement certified by the borrower or by the company secretary or a director of the borrower on its behalf, or by a counsel, whether external or internal, will be acceptable to the Collector.

23. Borrowers may register stock borrowing and lending agreements via GovHK or by completing the paper Stock Borrowing and Lending Agreement Registration Form (Form SBUL 2, see paragraph 55). All information contained in stock borrowing and lending agreements and returns of stock borrowing and stock return transactions (Returns of Stock Borrowing Transactions, see paragraph 52) will be kept strictly confidential. For paper registration, the submitted executed copy or true copy of the agreement, as the case may be, will be returned as soon as practicable to the borrower after being endorsed with a registration number and stamped to acknowledge receipt of the fee. The effective date of registration will be the date on which the required documents and registration fee are received by the Collector.

Bi-functional stock borrowing and lending agreements

24. Under a bi-functional stock borrowing and lending agreement, each party to the agreement may be acting as a lender as well as a borrower. In other words, parties executing such an agreement, as borrowers under the agreement, may separately register the agreement. Each of the parties can do so via GovHK or by completing Form SBUL 2. The requirement to register an agreement twice only applies where both parties intend to borrow Hong Kong stock under the agreement

and enjoy the Relief. Both parties applying for registration of the agreement are required to pay separate registration fees for each registration. Where the parties have executed a standard bi-functional stock borrowing and lending agreement but only one party intends to borrow Hong Kong stock under the agreement, only the intended borrower needs to register the agreement. Nevertheless, it should be noted that if the other party subsequently wishes to borrow Hong Kong stock, it needs to register the agreement as required within the time limit specified in section 19(12A), failing which its stock borrowings and stock returns effected will not qualify for the Relief.

Notification by lenders

25. Strictly speaking, in case stamp duty is exigible both lender and borrower are chargeable as each is liable to duty on its own contract notes. However, a lender under a stock borrowing and lending agreement may not be in a position to ensure that the borrower registers the agreement in time, or may not be aware of the borrower's failure to effect registration. In such situations, the Collector will not impose stamp duty on the lender (except where mala fide is shown), provided that the lender has taken reasonable care to ensure that the borrower is aware of the requirement to register the agreement within the time limit as laid down in section 19(12A). This may be done, for example, by stipulating in the agreement that the borrower is to register the agreement with the Collector, or by otherwise informing the borrower of such registration requirements. A lender who wishes to avail himself of this concession must also advise the Collector via GovHK or by completing the paper Notification of Execution of Stock Borrowing and Lending Agreement by Lender (Form SBUL 26, see paragraph 55) as soon as he has lent stock to a borrower under a stock borrowing and lending agreement. This concession will also be applied in relation to the potential stamp duty liability of a lender in respect of a borrower's failure to maintain a ledger containing the prescribed particulars or to file the prescribed returns, in which case the stock borrowing effected may not qualify for the Relief (see paragraph 49).

Stock return

26. Under section 19(16), a "stock return", in relation to a stock borrowing, means a transaction by which the borrower returns or delivers to the lender *stock of the same description* as, or any "*reasonable equivalent*" of, the borrowed stock, whether it is made:-

- directly to the lender; or
- indirectly under or through a recognized clearing house and in accordance with the rules of that clearing house.

27. The definition of “stock return” specifically excludes transactions relating to borrowed stocks that are not qualified for the Relief for reasons specified under section 19(12) (see paragraph 33). That is to say, in case where borrowed stocks are used for a purpose other than the specified purposes, or where a borrower fails to meet a demand for returning stocks, including a term loan of stocks (unless an extension of the time allowed to comply with the demand is granted by the lender), the subsequent transaction of returning stocks in respect of such stock borrowing will be excluded from the Relief.

Stock return in special circumstances – reasonable equivalent

28. The definition of “stock return” spells out clearly the treatment of the borrowed stock in special circumstances (the occurrence of a *relevant event* as defined in section 19(16)) in which the return of stock of the same quantity and description has become impracticable or inappropriate. In such circumstances, the delivery of a “reasonable equivalent” of the borrowed stock is accepted as constituting a stock return. The term “reasonable equivalent” is defined in section 19(16) to mean “any stock or monies which, in the Collector’s opinion, can be reasonably and fairly be regarded as the equivalent of the stock borrowed as a result of the occurrence of a *relevant event*”. As a general rule, the treatment as provided in the stock borrowing and lending agreement in circumstances similar to the *relevant event* will be considered by the Collector in determining the reasonable equivalent of the borrowed stock and this will usually be accepted unless it is found to be manifestly unreasonable.

29. The term “relevant event” is defined in section 19(16) to mean, in relation to the stock borrowed:-

- the exercise of any of the powers conferred by section 53(1)(a) to (d) of the Companies Ordinance (Cap. 32) as in force from time to time before 3 March 2014;

- the exercise of any of the powers conferred by sections 170(2)(a) to (e) and 174(1) of the Companies Ordinance (Cap. 622); or
- any other event,

which, in the opinion of the Collector, makes any requirement to return stock of the same quantity and description as the stock borrowed either impracticable or inappropriate.

30. Though relevant events commonly occur upon the exercise of the powers of a company limited by shares conferred by section 170(2)(a) to (e) of the Companies Ordinance (Cap. 622) to alter its share capital, there will indeed be unlimited situations which may make the return of the same quantity and description of the borrowed stock impracticable or inappropriate. The followings are some of the possible relevant events and the corresponding stocks or monies returned that would be treated as the reasonable equivalent:-

- a conversion, subdivision or consolidation – the securities into which the borrowed stock has been converted, subdivided or consolidated;
- a take-over – the securities and/or monies which the lender has directed the borrower to accept;
- a call on partly paid securities – the paid-up securities (provided that the lender has paid to the borrower the sum due on the call);
- a bonus issue – the borrowed stock together with the bonus securities allotted;
- a rights issue – where the lender has directed the borrower to take up the issue and has paid to the borrower any sums due on the issue, the borrowed stock together with the securities allotted under the rights issue.

31. It may happen that a stock listed on the SEHK at the time of a stock borrowing was subsequently de-listed in circumstances where a borrower still has outstanding stock loans in respect of that stock. As it would then be impracticable for the borrower to return the stock in its former listed form, the Collector is prepared

to treat the borrower as having made a stock return if the borrower compensates the lender with monies in a reasonable amount equivalent to the value of the outstanding borrowed stock. However, the above treatment will not apply to situations when the stock is temporarily suspended. For cases where there are practical difficulties in returning the borrowed stocks, such as continued suspension of trading for over three months, the borrower may submit representations to the Collector for consideration.

Partial stock return

32. A partial stock return is permissible. However, the balance of any stock borrowed from the initial transaction which the borrower ceased to be required to make a return or which the borrower fails to return according to the demand made by the lender will be deemed to have been bought and sold by the borrower under section 19(12). Stamp duty is chargeable on the deemed sale and purchase in the manner as described in paragraph 37.

Stock borrowing deemed to be sale and purchase

33. Under section 19(12), a stock borrowing is deemed to be a sale and a purchase of the borrowed stock (or part of it, or its reasonable equivalent, as the case may be) in circumstances where:-

- (a) the borrower ceases to be required by the lender to make a stock return in respect of the whole or part of the borrowed stock, or its reasonable equivalent;
- (b) the borrowed stock, or part of it, or its reasonable equivalent has been used other than for a specified purpose; or
- (c) the borrower fails to comply with a demand by the lender for the return of the whole or part of the borrowed stock, or its reasonable equivalent.

34. A stock loan can be left outstanding for an unlimited period of time without breaching the conditions for the Relief. However, when both the lender and the borrower, pursuant to their stock borrowing and lending agreement or to any other agreement made between them, agree to settle the stock loan otherwise than by making a stock return, the Relief previously granted to the stock borrowing

transaction will be withdrawn.

35. One of the possible scenarios to which section 19(12)(a) may apply to withdraw the Relief is the settlement of the stock loan by forfeiting the collateral, by the lender, pledged to secure the stock loan. Nevertheless, section 19(12)(a) may not apply if the borrower's obligation to make a stock return is terminated in consequence of the exercising of a right by the lender under the stock borrowing and lending agreement, or upon a request by the borrower, to purchase the like amount of the borrowed stock or its reasonable equivalent (the Replacement Stocks) in the principal market in a commercial manner, and the cost is to be borne by the borrower or to be applied and set off against the collateral and any other money due to the borrower. In such a case the purchase of the Replacement Stocks by the lender is accepted to be a stock return made by the borrower. It should be noted that this treatment is only applicable to cases where the purchase of the Replacement Stocks by the lender is effected *before* the borrower's obligation to return the borrowed stock is terminated. In the case where the borrower fails to comply with a demand of the lender to return the stock, the failure will be caught by section 19(12)(c). The subsequent purchase of the Replacement Stocks by the lender under this situation does not satisfy the definition of a "stock return" (see paragraph 27).

36. The borrower who claims to have made a stock return by way of the lender's purchase of Replacement Stock should retain sufficient evidence to show the purchase of the Replacement Stock by the lender; that the purchase of stock by the lender is provided for under the stock borrowing and lending agreement or is upon his (the borrower's) instruction; and that the stock loan is not terminated before the Replacement Stock is purchased. The return of stock under a stock borrowing can also be made by way of off-setting the borrowed stock in a new stock borrowing effected under the *same* stock borrowing and lending agreement, or by a delivery obligation of the stock borrowed between the same borrower and lender. The latter scenario can be illustrated by the following example:-

Under a stock borrowing and lending agreement, A has an obligation to return certain stock Z to B. At the same time, A has an Option contract with B to purchase stock Z. To discharge its obligation under the stock borrowing and lending agreement, A exercises his purchase option under the Option contract to purchase stock Z for the purpose of effecting a stock return to B. Since the stock Z that B is required to deliver to A under the Option contract would have to be delivered simultaneously back to B by A

under the stock borrowing and lending agreement, the delivery of stock Z by B to A is dispensed with and the obligation of A under the stock borrowing and lending agreement is discharged. Under the circumstances, the Collector will accept that A has made a stock return for the purposes of section 19(12), notwithstanding that there is no physical delivery of the stocks. However, the borrower should maintain proper and full records relating to the set-off for verification.

37. Pursuant to section 19(12AA), where a stock borrowing is deemed to be a sale and a purchase of the borrowed stock (either in whole or in part) or of its reasonable equivalent, contract notes must be made, executed and stamped in accordance with section 19(1)(a), (b) and (c) as if the sale and purchase of that stock (or that part of it, or its reasonable equivalent, as the case may be) had been effected in Hong Kong:-

- by the borrower (who will be solely liable for paying stamp duty on both the sold note and the bought note),
- on the “*specified day*”, and
- for a consideration based on the closing price of stock of the same description as the stock which is the subject of the sale and purchase on the day preceding the specified day.

The closing price should be determined in accordance with the rules and practices of the SEHK.

38. The Stamp Office will accept a single set of bought and sold notes made and executed by the borrower to cover both the stock borrowing transaction *and* the corresponding stock return transaction (if any) to which section 19(12) applies. Form SBUL 27 (see paragraph 55) is a sample format for such contract notes.

Specified day

39. The term “specified day” is defined in section 19(16) to mean:-

- where the borrower ceases to be required to make a stock return – the day on which such event occurs;

- where the borrowed stock (or its reasonable equivalent) is used for a non-specified purpose – the day on which the borrowed stock was obtained. Strictly speaking, in such a deemed sale and purchase transaction the borrower is liable to a penalty for late stamping if the applicable time limit set out in section 19(1)(b) is not complied with. However, the Collector may consider a remission of the penalty where circumstances warrant; or
- where the borrower fails to comply with a lender’s demand for return of the borrowed stock (or its reasonable equivalent) – the day on which the borrower fails to comply with the demand.

Repurchase agreements

40. For stamp duty purposes, certain “repo” and “reverse repo” transactions under repurchase agreements might be regarded as stock borrowing and lending transactions. Typically, a person who has equity and debt securities and needs cash (the seller) initiates a stock repurchase transaction, or repo, by selling the securities to another person who has cash (the buyer) and agreeing to repurchase a like amount of identical securities from the buyer at a specified price in the future, either at a set date or on demand. The repurchase price includes a premium usually referred to as a “price differential” over the original cash purchase price as compensation for the use of the cash. Where the transaction is initiated by the buyer, it is known as a “reverse repo”. Repo and reverse repo transactions are generally entered into for (i) liquidity management, i.e. for the buyer to gain a return on his funds, (ii) intermediation, and (iii) at times, to cover short sales or failures to deliver by customers. In the following paragraphs, the term “repo” is used to refer to both repo and reverse repo transactions.

41. The Collector recognizes that repos and stock borrowing and lending transactions can be economically equivalent despite the different legal forms in which they are structured and carried out. Provided that the following conditions are satisfied, the Collector will treat a repurchase agreement as equivalent to a stock borrowing and lending agreement:-

- the transaction must be in respect of the sale or repurchase of *Hong Kong stock*;

- the Hong Kong stock obtained by the buyer must be used for one or more than one specified purpose. Stock obtained by a buyer for the purposes of liquidity management (see paragraph 40) will be accepted by the Collector as “specified purpose” within the meaning of section 19(16) of the SDO;
- apart from the provisions for obtaining and returning stocks, the repurchase agreement must provide for the making of specified payment by the buyer to the seller similar to which is required in the case of a normal stock borrowing and lending agreement (see paragraph 10);
- the agreement does not have the effect of reducing the seller’s (lender’s) risk of loss or opportunity for gain from the stock (see paragraph 11); and
- the filing, record keeping and reporting requirements under section 19(12A) and (13) are complied with.

42. Without prejudice to the right of the Collector to act otherwise, the Collector may accept a repurchase agreement in the format of one of the following versions of standard master agreement for repo transactions published by the Securities Industry and Financial Markets Association¹ (SIFMA) and the International Capital Market Association² (ICMA) or their predecessor organisations as containing the necessary provisions to qualify it as a stock borrowing and lending agreement:-

- (a) SIFMA/ICMA Global Master Repurchase Agreement (2011 Version)
- (b) TBMA/ISMA Global Master Repurchase Agreement (2000 Version)
- (c) TBMA Master Repurchase Agreement (1996 Version)
- (d) PSA/ISMA Global Master Repurchase Agreement (1995 Version)

Accordingly, a stock sale transaction and the corresponding stock repurchase transaction effected under such an agreement will be regarded as a “stock borrowing” and a “stock return” respectively. The seller and buyer will be respectively regarded as “lender” and “borrower” for the purposes of the relevant provisions of the SDO.

¹ SIFMA was formed as a result of the merger between the Securities Industry Association (SIA) and TBMA in 2006. SIA is the successor organisation to the Public Securities Association (PSA).

² ICMA was formed as a result of the merger between the International Securities Market Association (ISMA) and the International Primary Market Association (IPMA) in 2005.

Buy-sell transactions effected under a repurchase agreement

43. A repurchase agreement may also provide that the transaction can be conducted in another way: “Buy and Sell-back”. Basically, this type of transaction is similar to a repo in that the seller sells securities to the buyer and the buyer subsequently returns those securities to the seller. The only difference is that the buyer in a buy-sell transaction may NOT be required to pass on the specified payment (or manufactured dividends) to the seller (the original stock owner). A repurchase agreement which contains provisions allowing for these transactions does not strictly comply with the requirements under paragraph (a)(i)(C)(I) of the definition of “stock borrowing and lending agreement” in that no specified payment will be made by the buyer to the seller (see paragraph 10). However, it can still be accepted by the Collector as complying with paragraph (a)(i)(C)(II) of the definition if the Collector is satisfied that the transaction is at arm’s length and that:-

- the method for determining the repurchase price of the stock provided for under the agreement has taken into account of the possible amount of the manufactured dividends; and
- the formula used to calculate the sell back price of the stock in the event that the buyer cannot honour the selling back of the stock on the agreed date has taken into account of the paying back of the manufactured dividends to the original stock owner (the seller).

Stock collateral

44. Under a stock borrowing and lending transaction (and sometimes under a repo), stocks or other securities may be provided by the borrower (or buyer) as collateral. Where Hong Kong stock is involved, the Collector is of the view that the initial transfer of the collateral and the transfer upon its return are both exempt from ad valorem stamp duty by virtue of section 27(5) of the SDO. This section applies to any “transfer made for nominal consideration for the purpose of securing the repayment of a *loan*”. The ordinary meaning of the word “loan” certainly includes a stock loan. For present purposes, it is accepted that stock borrowing and lending transactions and repos are in substance stock loans. The nature of the transaction is not affected by the fact that complete title to the collateral actually transfers from the borrower to the lender (or from the buyer to the seller) and then back again when the borrowed stock is returned. Section 27(5) is precisely intended to provide relief for

outright transfers of stock used as security.

45. In practice, where collateral is involved, the parties to a stock borrowing and lending agreement (or repo) may produce the transfer documents in respect of the stock collateral to the Stamp Office for stamping together with supporting evidence such as the related stock borrowing and lending agreement or repurchase agreement. Each transfer document will be stamped with a fixed duty of \$5 [head 2(4) in the First Schedule to the SDO] and denoted with a “No Ad Valorem Duty Payable” stamp to facilitate that registration process.

Agency stock loan agreement

46. Where custodians lend out stock deposited with them by clients, they merely act as agents for their clients who are regarded as the principals in the stock loan transactions. In most cases, custodians act as agents for “undisclosed” principals to avoid revealing the identities of their clients. The situation is exacerbated where a custodian lends on behalf of a “pooled investor”, such as a mutual fund, in which case it may not be possible to identify the actual beneficial owners of the stock. Even where the custodian is able to identify and allocate a loan to specific clients, the “composition” of the underlying lenders may change during the duration of the loan. Typically, custodians, acting as agents on behalf of undisclosed or disclosed principals, execute one stock loan agreement (commonly referred to as *agency stock loan agreement*) with each borrower. Consistent with this practice, borrowers treat such a custodian as a single counter-party for booking and reporting purposes.

47. In view of the practical difficulties encountered by custodians in identifying the underlying principals under such agency stock loan agreements and the fungibility of stocks, the Collector will accept that in relation to such agreements:-

- a custodian may enter into an agency stock loan agreement with a borrower(s) on behalf of undisclosed or disclosed principals in its capacity as an agent;
- a custodian who has entered into an agency stock loan agreement can discharge its obligations *under the stock borrowing regime* by informing the Stamp Office as per paragraph 25;

- under an agency stock loan agreement, whether the custodian is acting on a disclosed or undisclosed principal basis, the borrower is only obliged to register with the Collector his master agreement once with the custodian as lender. The name of the “lender” may be stated in the Stock Borrowing and Lending Agreement Registration Form as, for example, “A Ltd. acting as agent”. The borrower is not required to register an agreement for each client of the custodian; and
- a borrower under an agency stock loan agreement can treat all loans with a single custodian agent as loans from a single counter-party.

48. Where the lender acts in dual capacity as a principal and an agent under an agency stock loan agreement, only a single registration of the agreement with the Collector is required. The name and capacity of the lender should be stated in the Stock Borrowing and Lending Agreement Registration Form as, for example, “A Ltd. acting as principal and agent”.

RECORD KEEPING AND REPORTING

49. A borrower who has effected stock borrowings under a stock borrowing and lending agreement registered with the Collector is required under section 19(13) to:-

- maintain a stock borrowing ledger in a form prescribed by the Collector;
- enter required particulars in respect of the stock borrowings and the related stock returns into that ledger; and
- provide the Collector with a Return of Stock Borrowing Transactions, as required.

Since these requirements are conditions for the grant of the Relief under section 19(11), the failure in complying with any such requirements may render the stock borrowings and the related stock returns not qualified for the Relief.

50. The Collector has prescribed that the stock borrowing ledger may be kept in paper form, in electronic form (with the relevant information supplied in hard copy

format upon request by the Collector), or a combination of both. The ledger should contain the following particulars in respect of each stock borrowing and the related stock return:-

re stock borrowing

- date of the stock borrowing
- reference number³ to identify the stock borrowing
- description⁴ of the stock borrowed
- quantity of stock borrowed
- details of any stamp duty paid

re stock return

- date of the stock return
- reference number³ of the related stock borrowing
- description⁴ of the stock returned
- quantity of stock returned
- details of any stamp duty paid

Form SBUL 3 (see paragraph 55) is a sample format of a stock borrowing ledger. Borrowers may, however, modify the sample format to suit their own requirements, provided that the required information is fully recorded.

51. The stock borrowing ledger must be kept at the borrower's usual place of business and is to be available for inspection by the Collector or his duly authorized officers upon request.

³ This could be the number of the contract note in respect of the stock borrowing required to be made and executed by the borrower under section 152 of the Securities and Futures Ordinance, Cap. 571, or any other unique reference number allotted.

⁴ Either the name of the stock, or its stock exchange code, or both.

52. The Collector also requires borrowers, who have effected stock borrowings under registered stock borrowing and lending agreements, to prepare Return of Stock Borrowing Transactions in the format of Form SBUL 1 (see paragraph 55) to report the stock borrowing and stock return transactions for each six-month period ended on the two dates of 30 June and 31 December annually, and filed the Returns within 1 month after those dates. A borrower who has registered more than one stock borrowing and lending agreement may furnish a composite return setting out information on stock borrowing and stock return transactions made in respect of those agreements. However, a separate sheet for Part B of the Return has to be completed for each agreement. The borrower may slightly modify the layout of Part B of the Return according to his particular needs as long as the Return adopted contains all the particulars and items of Form SBUL 1.

COMPLIANCE CHECKS

53. To ensure proper compliance, the Collector or his duly authorized officers may conduct compliance checks, including desk audits and inspections, on borrowers to verify the correctness of the Returns of Stock Borrowing Transactions and the entries in the stock borrowing ledgers.

PENALTIES

54. It is essential for borrowers receiving the Relief to comply with the record keeping and reporting requirements. In this regard, the SDO provides for the imposition of the following penalties:-

- a fine at level 2 (\$5,000) recoverable by the Collector as a civil debt due to the Government where a borrower fails to maintain a stock borrowing ledger, fails to make a proper entry in respect of each stock borrowing or its related stock return, or fails to file a Return of Stock Borrowing Transactions within the specified time;
- a fine at level 6 (\$100,000) and imprisonment for one year where a borrower enters any false or misleading particular in a stock borrowing ledger or a Return of Stock Borrowing Transactions with

intent to defraud the Government of any stamp duty.

FORMS

55. The following forms could be downloaded from the web site of the Department (www.ird.gov.hk):-

Form SBUL 1 – Return of Stock Borrowing Transactions

Form SBUL 2 – Stock Borrowing and Lending Agreement Registration Form

Form SBUL 3 – Stock Borrowing Ledger

Form SBUL 26 – Notification of Execution of Stock Borrowing and Lending Agreement by Lender

Form SBUL 27 – Format of contract notes for deemed sale and purchase of Hong Kong stock under section 19(12) of the SDO