



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

STAMP OFFICE INTERPRETATION & PRACTICE NOTES

NO. 4

DEEMED SALE AND PURCHASE UNDER SECTION 19(1E) OF THE STAMP DUTY ORDINANCE, CAP. 117

These notes contain a summary of the Departmental interpretation and practice and are issued for general information and guidance only. They have no binding force and do not affect a person's right of appeal to the Courts.

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INTRODUCTION

The Stamp Duty (Amendment) (No. 2) Ordinance 1998 introduced a new section 19(1E) to the Stamp Duty Ordinance, Cap. 117 (the Ordinance) which came into operation on 1 May 1998. This section deems certain transactions in Hong Kong stock¹ to be a sale and purchase of the stock. Contract notes are therefore required to be made and executed for such deemed sale and purchase and stamp duty is payable on these notes under Head 2(1) in the First Schedule to the Ordinance by reference to the value of the stock transferred. This Practice Note sets out the current practice of the Collector of Stamp Revenue (Collector) in administering these provisions.

TRANSACTIONS DEEMED TO BE SALE AND PURCHASE

2. Paragraph (a) of section 19(1E) provides that in the case of a transaction whereby the beneficial interest in Hong Kong stock passes otherwise than by sale and purchase, and the transaction is not effectuated by way of a transfer chargeable with stamp duty under head 2(3) in the First Schedule to the Ordinance², the transaction shall be deemed to be a sale and purchase of the Hong Kong stock. This section covers transactions effectuated by any means, whether by electronic means or by means of an entry in any recording or book-keeping system or otherwise, and whether through a recognized clearing house³ or any other person or organization such as stock brokers, custodians, etc. providing a clearing or transfer service.

3. The critical factor for the application of section 19(1E)(a) is whether the transaction in question effectuates a transfer of beneficial interest in Hong Kong stock. Hence, if the recording, settlement or any other such activity by whatever name called, serves to effectuate a transaction whereby the beneficial interest of the stock passes from the holder of an account in a clearing entity to the holder of another account, then section 19(1E)(a) is applicable. However, the section does not apply if the transaction falls within the exemption discussed in paragraph 4 below, or the

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1. "Hong Kong stock" means stock the transfer of which is required to be registered in Hong Kong [section 2(1)]. In other words, the share register of such stock is kept in Hong Kong. Generally speaking, all shares of companies incorporated in Hong Kong under the Companies Ordinance, Cap. 32 and all stocks listed on the Stock Exchange of Hong Kong are Hong Kong stocks. It should be noted that the term "stock" is widely defined to include other forms of investments such as bonds, debentures, units under a unit trust scheme, etc.
 2. A transfer under head 2(3) in the First Schedule is a transfer operating as a voluntary disposition inter vivos or made for the purpose of effectuating a transaction whereby the beneficial interest in Hong Kong stock passes otherwise than on sale and purchase, including a foreclosure order.
 3. "Recognised clearing house" means a recognized clearing house within the meaning of section 2 of the Securities (Clearing House) Ordinance, Cap. 420 [section 19(16)]. The Hong Kong Securities Clearing Co. Ltd. is such a recognized clearing house.

transaction is exempted under any other provisions of Ordinance (e.g. a transaction whereby the beneficial interest in Hong Kong stock passes from one associated body corporate to another under section 45 of the Ordinance). On the other hand, a mere book entry made in the books or recording system of a clearing entity between two accounts that belong beneficially to the same person does not trigger-off the application of section 19(1E)(a).

Exemption

4. Paragraph (c) of section 19(1E) provides that paragraph (a) shall not apply to a transaction of the kind referred to in that paragraph, where the transaction would, if it were effectuated by a transfer chargeable to stamp duty under head 2(3) in the First Schedule to the Ordinance (see foot note 2 on page 1), which is a transfer of the kind exempted under section 27(5). Section 27(5) exempts a transfer chargeable under head 2(3) from stamp duty if the transfer is made for nominal consideration for the purpose of securing the repayment of a loan, or for effectuating the appointment of a new trustee, or under which no beneficial interest passes, or the transfer is made to a beneficiary by a trustee or other person in a fiduciary duty under a trust. For this type of transfers, therefore, section 19(1E)(a) will have no application.

DEEMED PRINCIPAL

5. In a deemed sale and purchase under section 19(1E)(a), the person disposing of the stock in the transaction is deemed to be the person effecting the sale, i.e. the seller. Likewise, the person acquiring the stock in the transaction is deemed to be the person effecting the purchase, i.e. the purchaser [sub-paragraphs (i) and (ii) of section 19(1E)(b)]. Note that the deemed seller and the deemed purchaser are the principals in the transaction. The significance of these deeming provisions is that the principals are the persons liable to make and execute the relevant contract notes and to pay the applicable stamp duty, unless an agent (or a deemed agent as per paragraph 6 below) exists [section 19(1) and item (C) in head 2(1) in the First Schedule].

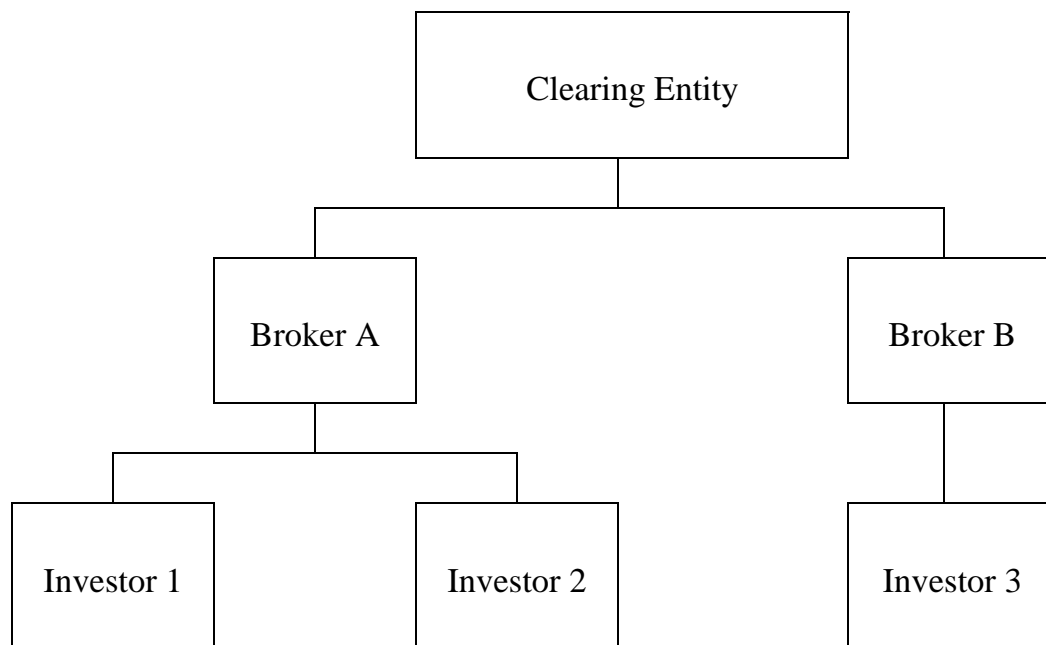
DEEMED AGENT

6. The person maintaining the record of the transaction who is not the principal effecting the deemed sale and purchase is deemed to be the agent effecting the sale and purchase [sub-paragraph (iii) of section 19(1E)(b)]. Such an agent is the person liable to pay the requisite stamp duty [item (C) in head 2(1) in the First Schedule] and responsible to make and execute the relevant contract notes as required under section 19(1). A recognized clearing house is specifically exempted from this provision.

Multi-tier Scenario

7. In the actual operations of the investment market, stocks may be held under a “multi-tier holding environment”. For example, a stock broker who holds stocks on behalf of its customers (who maintain accounts with him) may in turn deposit the stocks in an account held under the clearing and settlement system of a clearing entity.

8. The following diagram and explanation illustrate the stamp duty liabilities of the related parties involved in a multi-tier holding environment -



Investor 1 owns Hong Kong stock and deposits it with Broker A, who in turn deposits it with the Clearing Entity. In Broker A’s recording system, a credit entry is made in respect of the stock account of Investor 1 and a debit entry is made in respect of the Clearing Entity. Conversely, in the recording system of the Clearing Entity, a credit entry is made in respect of Broker A.

(a) **Case 1**

Hong Kong stock is transferred from Investor 1 to Investor 2, who are both clients of Broker A. The transfer is effectuated by an entry made in the recording system of Broker A, viz. a debit made in the stock account of Investor 1 and a credit made in the stock account of Investor 2 in respect of the stock transferred. The transfer passes the beneficial interest in the stock but is not made pursuant to a sale and purchase.

In this case, the transaction shall for stamp duty purposes be deemed to be a sale and purchase of the Hong Kong stock by virtue of section 19(1E)(a). Broker A will be deemed to be the agent of the deemed sale and purchase. Hence, Broker A will be obliged to make and execute contract notes in respect of the deemed sale and purchase under section 19 and will be held liable for payment of the applicable stamp duty in accordance with head 2(1).

As there will not be any movement in the Clearing Entity level, the Clearing Entity will not be involved in this transaction.

(b) **Case 2**

Hong Kong stock is transferred from Investor 1, a client of Broker A to Investor 3, a client of Broker B. The transfer is effectuated by an entry made in the recording system of the Clearing Entity, viz. a debit made in the stock account of Broker A (holding on behalf of Investor 1), and a credit made in the stock account of Broker B (holding on behalf of Investor 3) in respect of the stock transferred. The transfer passes the beneficial interest in the stock but is not made pursuant to a sale and purchase.

For the purpose of clearing, Broker A must first make an entry in its recording system, viz. to debit the stock account of Investor 1 and to credit the stock account of the Clearing Entity in respect of the stock transferred.

Likewise, for the purpose of clearing, Broker B must also make an entry in its recording system, viz. to debit the stock account of the Clearing Entity and to credit the stock account of Investor 3 in respect of the stock received.

The analysis is as follows -

(i) Clearing Entity

The transaction effectuated by entries made in its recording system in respect of the transfer of the stock from Broker A to Broker B is prima facie a transaction within the meaning of section 19(1E)(a) and would thus trigger-off the deeming provisions. The transaction shall be deemed to be a sale and purchase of the stock in question. Investor 1 shall be deemed to be the seller and Investor 3 shall be deemed to be the purchaser.

If the Clearing Entity is not a recognized clearing house, it shall be deemed to be the agent effecting the deemed sale and purchase. It will thus be obliged to execute the contract notes for stamping and will be liable for payment of the applicable stamp duty in accordance with head 2(1). However, if the Clearing Entity is a recognized clearing house, it will not be deemed to be the agent effecting the deemed sale and purchase transaction by virtue of the specific exemption provided in section 19(1E)(b)(iii).

(ii) Broker A and Broker B

The transactions effectuated by entries made in the recording systems of Broker A and Broker B in respect of the transfers of the stock from Investor 1 to the Clearing Entity and from the Clearing Entity to Investor 3 respectively do not give rise to the application of section 19(1E). In the individual recording systems, these transactions are made for the purpose of clearing and there is no passing of beneficial interest in the stock by way of such transactions.

As far as Broker A is concerned, before the entry referred to in paragraph (i) above is made by the Clearing Entity, Investor 1 was all along the beneficial owner of the stock despite the entry made in the recording system of Broker A (i.e. debit Investor 1 and

credit the Clearing Entity). The position is then reversed upon the transfer to Investor 3 through the Clearing Entity. Likewise, for Broker B, once the entry referred to in paragraph (i) above is made by the Clearing Entity, Investor 3 became the beneficial owner of the stock irrespective of the entries made in the recording system of Broker B (i.e. debit the Clearing Entity and credit Investor 3).

However, it should be noted that if the Clearing Entity *is* a recognized clearing house and hence exempted under section 19(1E)(b)(iii), the stamp duty liability will fall upon the persons disposing of/acquiring the stock (i.e. Investor 1 and Investor 3 respectively). As Broker A and Broker B are the agents (in the true sense of the word) for the parties effecting the deemed sale or purchase, they are obliged to execute the Sold Note and Bought Note for stamping and will be held liable for payment of the applicable stamp duty under head 2(1).

9. Situations involving more than 3 levels of holdings will be treated in a similar fashion. The basic principle is that whenever a clearing entity allows a transfer of stock to take place between the accounts of its clients, it will be deemed to be the agent of the deemed sale and purchase unless it can be proved that section 19(1E)(a) is not applicable.

DEEMED CONSIDERATION

10. In a deemed sale and purchase under section 19(1E)(a), the value of the stock in the transaction shall be deemed to be the amount or value of the consideration for the purpose of calculating the stamp duty liability [sub-paragraph (iv) of section 19(1E)(b)]. As a common practice, in ascertaining the value of those Hong Kong stocks listed on the Stock Exchange, the closing price of the stock on the trade day immediately prior to the date of the captioned transaction will be adopted as the value of these stocks.

PAYMENT OF STAMP DUTY AND STAMPING OF CONTRACT NOTES

11. Contract notes executed for the deemed sale and purchase transactions under section 19(1E)(a) shall be in the same form as the contract notes executed for ordinary trades and shall include all the items required under section 19(2). The only exception is that the consideration for the transaction should be stated as the value of the stock transferred as explained in the preceding paragraph.

12. The captioned contract notes should be presented to the Stamp Office for stamping within the time limit for stamping contract notes generally (i.e. 2 days after the day of the transaction if effected in Hong Kong or 30 days if effected outside Hong Kong) [item (B) in head 2(1) in the First Schedule]. For broker members of the Stock Exchange of Hong Kong Ltd., they may choose, if they so wish, to pay the stamp duty through the Stock Exchange and execute the contract notes with the usual certification of the payment of stamp duty in the same manner as for normal stock transactions effected by them through the Stock Exchange. However, for identification purposes and to facilitate stamp duty inspection, a note is required to be made on the contract notes as follows -

This is a deemed sale or purchase under section 19(1E) of the Stamp Duty Ordinance.
(or words to similar effect)