STAMP OFFICE INTERPRETATION AND PRACTICE NOTES

NO. 6

ALTERNATIVE BOND SCHEMES

These notes are issued for the information of duty payers and their tax 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.

WONG Kuen-fai
Collector of Stamp Revenue

August 2014
**STAMP OFFICE INTERPRETATION AND PRACTICE NOTES**

No. 6

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INTRODUCTION

To facilitate the development of sukuk market in Hong Kong, the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013 (the Amendment Ordinance) was enacted to provide a comparable taxation framework for sukuk vis-à-vis conventional bonds. The Amendment Ordinance introduced certain amendments to the Stamp Duty Ordinance (the Ordinance) and the Inland Revenue Ordinance (the IRO). This Stamp Office Interpretation and Practice Note sets out the interpretation of the stamp duty provisions and the practice to be followed by the Stamp Office whereas Departmental Interpretation and Practice Notes No. 50 (DIPN 50) covers the Department’s views and practice on the application of the provisions in section 40AB and Schedule 17A of the IRO.

2. Sukuk, commonly called Islamic bonds, are one of the most prominent instruments issued by some corporates or sovereigns in order to raise funds in the international capital markets. These Islamic bonds, either asset-based or asset-backed, represent their holders’ undivided ownership in the underlying asset and their right to receive profits or income generated by the asset. Since the receipt and payment of interest (riba) are prohibited under Sharia principles, unlike conventional bonds which are debt-based instruments that pay interest, issuance of sukuk typically involves more complex structures such as setting up of a special purpose vehicle, multiple transfers and lease of the underlying asset for the purposes of generating returns in the form of rental income, trading gains or profits. If the underlying asset involved is Hong Kong stock or immovable property in Hong Kong, stamp duty payable on the transfer of such asset has been perceived by the market as an impediment to developing an Islamic bond market in Hong Kong.

3. Sections 47C to 47L and Schedule 6 of the Ordinance provide for relief from stamp duty on certain instruments executed solely for compliance of Sharia principles and not otherwise required in the case of conventional bonds. The objective of the new provisions is to allow comparable treatment for conventional bonds and Islamic bonds under the Ordinance if the latter have the same economic substance as that of conventional bonds.
ALTERNATIVE BOND SCHEME

4. In *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd and Others* [2004] All ER 1072, the English Court of Appeal held that English law alone was the governing law even though the governing law clause was subject to Sharia principles. In the legislative amendment, a prescriptive and religion-neutral approach without any reference to Sharia principles was adopted. A new term known as alternative bond scheme (the ABS) is introduced which contains two arrangements, namely bond arrangement (the BA) and investment arrangement (the IA). The former refers to the arrangement between the bond-issuer (the BI) and the bond-holders (the BHs) while the latter refers to the arrangement between the BI and the originator (the O). The instruments issued under the BA are “alternative bonds”.

SCOPE

5. The Ordinance provides for stamp duty relief for five most common types of ABS product structures (see paragraph 6 below) in the global market, and prescribes their major features and characteristics. In order to accommodate other types of ABS where new product structures become popular, the Financial Secretary is empowered to expand the coverage of eligible ABS by way of subsidiary legislation in future.

SPECIFIED ABS

6. An ABS must meet certain core features, particularly containing a BA and an IA with a tripartite structure involving the O, the BI and the BHs. An IA is a *specified IA* if it falls within one of the four specified IAs. The four specified IAs and the corresponding Islamic transactions/contracts are listed below –

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The respective product structures of the above specified IAs are illustrated in Appendices 1 to 4. An ABS is a specified ABS if the IA in that ABS is a specified IA and the terms of the ABS and the IA remain the same throughout the specified term.

**SPECIFIED ASSET TRANSACTION BETWEEN THE ORIGINATOR AND THE BOND-ISSUER AND ASSET TRANSACTION BETWEEN THE ORIGINATOR AND THE BUSINESS UNDERTAKING**

7. In each of the lease arrangement, purchase and sale arrangement and agency arrangement, the asset which the BI acquires with the bond proceeds is a specified asset. Any acquisition, lease and disposal of an asset as, or as part of, the specified asset between the O and the BI is a specified asset transaction between the O and the BI.

8. In the profits sharing arrangement, the specified asset means the interest in the business undertaking (the BU) acquired by the BI with the bond proceeds. The specified asset transaction between the O and the BI means the disposal of the interest in the BU by the BI to the O, whether or not in stages, by the end of the specified term of the specified ABS in return for the proceeds of disposal. An acquisition of an asset by the BU as a contribution in kind by the O in return for an interest in that BU, or any acquisition, lease and disposal of an asset by the BU from or to the O is an asset transaction between the O and the BU.

**QUALIFYING CONDITIONS FOR STAMP DUTY RELIEF**

9. To be qualified for stamp duty relief, the BA must be a qualified BA. The BA in a specified ABS is a qualified BA if the specified ABS always complies with the following conditions -

(a) the reasonable commercial return condition;

(b) the BA as financial liability condition;

(c) the Hong Kong connection condition;
(d) the maximum term length condition; and

(e) the arrangements performed according to terms condition.

10. A specified IA in a specified ABS is a qualified IA if the BA in the specified ABS has always been a qualified BA and the specified ABS always complies with the following two conditions—

(a) the BI as conduit condition; and

(b) the IA as financial liability condition.

11. The definitions of the expressions in relation to the ABS are contained in section 47C of the Ordinance, most of which have the same meaning as they have in Schedule 17A to the IRO. The above qualifying conditions for stamp duty relief are also basically the same as those for special tax treatments under the IRO. In respect of the Department’s interpretation on the various expressions and qualifying conditions, references should be made to paragraphs 4 to 103 of DIPN 50. When applying these expressions and qualifying conditions under the Ordinance, references to the Commissioner of Inland Revenue in those paragraphs are to be read as references to the Collector of Stamp Revenue (the Collector).

**STAMP DUTY RELIEF**

*Relief on qualified bond arrangement under section 47E*

12. In the context of Islamic finance, sukuk certificates evidence their holders’ ownership in the underlying asset. The transfer of the certificates would amount to the transfer of the underlying asset. If the underlying asset is Hong Kong stock or immovable property in Hong Kong, stamp duty liability may arise. To provide comparable treatment for a BA in the specified ABS vis-à-vis debt securities—

(a) the BHs under a qualified BA in a specified ABS are to be regarded as not having any legal or beneficial interest in the specified asset under the specified ABS; and
(b) an alternative bond issued under the qualified BA is to be regarded as a bond to which neither paragraph (b) nor (c) of the definition of loan capital in section 2 of the Ordinance applies.

13. The transfer of an alternative bond issued under a qualified BA in a specified ABS would not be treated as a transfer of the specified asset for stamp duty purposes, and will not be subject to stamp duty unless the alternative bond falls within the meaning of Hong Kong stock because it carries a right of conversion into stock or to the acquisition of any stock under section 2 of the Ordinance, is denominated in or redeemable in Hong Kong currency and the transfer of which is required to be registered in Hong Kong.

**Relief on qualified investment arrangement under section 47F**

14. Where the BA and a specified IA in a specified ABS comply with the respective conditions mentioned in paragraphs 9 and 10, subject to the security requirement in paragraph 23 below, stamp duty (including special stamp duty (SSD) and buyer’s stamp duty (BSD)) under the Ordinance is not chargeable on –

(a) the instrument executed either to effect a transaction of immovable property in Hong Kong or Hong Kong stock that is a specified asset transaction between the O and the BI or asset transaction between the O and the BU under that qualified IA (**IA transaction**); or as an agreement for an IA transaction; or

(b) the instrument required by the Ordinance to be made and executed for effecting an IA transaction (for example, contract notes required under section 19 of the Ordinance).

15. The examples in Appendix 5 illustrate the stamp duty relief with regard to the specified asset transactions between the O and the BI, and the asset transactions between the O and the BU, under a qualified IA in a specified ABS.
Relief resulting from modifications to sections 29CA and 29DA by Schedule 6

16. Under sections 29CA and 29DA of the Ordinance, SSD is chargeable on an agreement for sale or a conveyance on sale whereby the vendor or the transferor disposes of a residential property within a period of 24 months (if the property was acquired on or after 20 November 2010 and before 27 October 2012) or 36 months (if the property was acquired on or after 27 October 2012) beginning on the day the vendor or the transferor under that agreement or conveyance acquired the property. Subject to the security requirement in paragraph 23 below, Schedule 6 modifies sections 29CA and 29DA of the Ordinance to disregard the specified asset transactions between the O and the BI and asset transactions between the O and the BU under a qualified IA so that the specified ABS concerned would not be subject to additional liability for SSD under head 1(1B) or 1(1AA) in the First Schedule to the Ordinance, when compared with a conventional bond scheme.

17. For the purposes of SSD, where the residential property was acquired from a third party by the BI or the BU under a qualified IA in a specified ABS and sold by the BI or BU to the O, and the O sells it to another third party during or after the specified term of the scheme, the date when the property was acquired by the BI or the BU from the first-mentioned third party will be regarded as the date on which the O acquired the property.

18. Similarly, where the residential property was acquired by the O from a third party before it was acquired by the BI or the BU from the O, and then the property is sold to another third party by the BI or the BU during the specified term of the scheme, the date on which the O acquired the property from the first-mentioned third party will be regarded as the date on which the O acquired the property.

19. Further, where the residential property was acquired by the O from a third party before it was acquired by the BI or the BU from the O, the BI or the BU sold the property back to the O, and then the O sells the residential property to another third party, the date on which the O acquired the property from the first-mentioned third party will be regarded as the date on which the O acquired the property. The examples in Appendix 6 illustrate the treatment with regard to SSD under a qualified IA in a specified ABS.
20. The modifications under Schedule 6 will render the agreement for sale or conveyance on sale –

(a) not chargeable with the SSD by the operation of section 47G(1); or

(b) chargeable with the SSD of an amount that is less than the amount that would have been chargeable but for section 47G(1).

21. A reference in paragraph 18 above to the property acquired by the BU includes the property being acquired by it as a contribution in kind by the O in return for an interest in it.

22. Sections 29CA(4) and 29DA(4) are modified by Schedule 6 to cater for cases where a developer disposes of a building newly constructed on a piece of land after acquisition or disposes of the piece of land after the then existing building thereon is demolished. Examples illustrating the operation of sections 29CA(4) and 29DA(4) as modified by Schedule 6 are set out in Appendix 7.

SECURITY

23. To minimise the risk of irrecoverable duty in the event of withdrawal of stamp duty relief upon occurrence of an IA disqualifying event (see paragraph 26 below), security must be given by the O or the BI to the satisfaction of the Collector before relief will be granted under sections 47F and 47G. The security must be given in respect of the amount of the stamp duty, including BSD and SSD which, but for sections 47F(1) and 47G(1), would have been payable under the Ordinance or the amount of the SSD which is reduced by the operation of section 47G(1). Nevertheless, the Collector will not demand the security in respect of an IA transaction occurring at, or an agreement for sale or conveyance on sale of residential property executed at or after, the end of the specified term of the specified ABS. The example in Appendix 8 illustrates how the security will be demanded in relation to a qualified IA.
24. For this purpose, security in cash, banker’s undertaking or a registered first legal charge on the underlying listed shares or immovable property in Hong Kong are acceptable. A sample bank guarantee is attached at Appendix 9. The security should be furnished by the O or the BI to the Collector within 60 days after the date of execution of the relevant instruments.

CIRCUMSTANCES LEADING TO WITHDRAWAL OF RELIEF

25. Subject to the exception mentioned in paragraph 27 below, if an IA disqualifying event occurs at any time in relation to the specified ABS, despite the fact that the arrangement would have been such a qualified IA but for the revocation, the IA concerned is to be regarded (except in relation to the requirements on keeping of records) as never having been a qualified IA in a specified ABS.

26. In relation to an arrangement in a scheme that has been accepted to be a qualified IA in a specified ABS for the purposes of determining the stamp duty with which an instrument is chargeable, IA disqualifying event includes -

(a) the scheme is not a specified ABS at any time during the specified term of the scheme; or

(b) although the scheme is a specified ABS at all times during the specified term of the scheme, the scheme fails to comply with any of the conditions mentioned in paragraphs 9 and 10 above at any time during the specified term.

27. Where an ABS at the time an IA disqualifying event occurs is, and from the commencement of the specified term of the scheme up to the time the event occurs, has always been a specified ABS, and the ABS only fails to comply with the arrangements performed according to terms condition, the Collector may disregard the non-compliance if –

(a) the non-compliance was solely constituted by a delay, of more than 30 days, in disposing of the specified asset; and
(b) it is proved to the satisfaction of the Collector that there was a reasonable excuse for the delay.

Any delay of not more than 30 days in disposing of the specified asset will not result in a breach of the arrangements performed according to terms condition (see paragraphs 96 and 113 of DIPN 50).

CONSEQUENCES OF DISQUALIFICATION

Bond arrangement

28. If a BA in a specified ABS fails to comply with any of the conditions mentioned in paragraph 9 above, an instrument executed in respect of the transactions of the alternative bonds issued under the BA ceases from the date of the disqualifying event to be eligible for stamp duty treatment mentioned in paragraphs 12 and 13 above. Since the alternative bonds evidence the holders’ ownership in the underlying asset, a transfer of the alternative bonds would amount to the transfer of the underlying asset. If the underlying asset is Hong Kong stock or immovable property in Hong Kong, stamp duty liability may arise. The examples in Appendix 10 illustrate the stamp duty liability on the transfer of the alternative bonds after the occurrence of a disqualifying event.

Section 47H – Withdrawal of relief granted under sections 47F and 47G

Investment arrangement

29. Where an IA disqualifying event occurs, if any relief from stamp duty has been granted by the Collector in respect of any instrument executed in relation to an IA transaction or under the modifications to section 29CA or 29DA of the Ordinance, the relief is deemed to be withdrawn under section 47H.

30. The parties to the instrument in respect of an IA transaction are liable or jointly and severally liable to pay the ad valorem stamp duty (AVD) and SSD, and the buyer in the agreement for sale or the transferee in the conveyance on sale is liable to BSD. If the relief has been granted for an
instrument under the modifications to section 29CA or 29DA of the Ordinance, the vendor under the agreement or the transferor under the conveyance is liable to pay to the Collector the SSD that would have been chargeable on the instrument had the relief not been granted under section 47F(1) or 47G(1), or an amount by which the SSD chargeable is reduced because of the relief under section 47G(1).

31. The AVD, BSD and SSD mentioned in paragraph 30 above must be paid within 30 days after the IA disqualifying event occurs; or if there are 2 or more IA disqualifying events, within 30 days after the earliest IA disqualifying event occurs.

32. If the amount of the stamp duty is not paid within the 30 days mentioned in paragraph 31 above, the person(s) who is/are liable for the payment as mentioned in paragraph 30 above is/are liable or jointly and severally liable to a penalty. The amount of the penalty payable after a lapse of a period of time after the 30 days shall be the same as that calculated under section 9 of the Ordinance. However, the Collector may remit the whole or any part of any penalty so payable taking into account the circumstances of each case.

33. Notwithstanding the withdrawal of the stamp duty relief, the instrument concerned is still admissible in evidence for the purposes of section 13(6) of the Ordinance.

Section 47L - Assessment after deemed withdrawal of relief

34. Pursuant to section 47L, the Collector may make an assessment of the stamp duty mentioned in paragraph 30 above on a person who is liable, and may serve on the person a notice of the assessment by post within 7 days from the date on which the assessment is made.

35. If required by a person who is liable to pay the stamp duty on an instrument as mentioned in paragraph 30 above, the Collector must make an assessment of the stamp duty so payable for the instrument and serve on the person a notice of the assessment by post within 7 days from the date on which the assessment is made.
36. If the person on which the assessment is served is aggrieved by the assessment, the person can lodge an appeal to the District Court against the assessment within 1 month from the date on which the assessment is made. The assessment is, after the expiry of the 1 month period, final and conclusive for all purposes as against the person, except if and to the extent to which an appeal made against it under section 14 of the Ordinance succeeds. The making of assessment does not relieve the person of his liability to any penalty to which the person would otherwise be liable.

37. If, within a period of 1 month from the date on which an assessment is made, it appears to the Collector that the amount of the stamp duty so assessed is excessive, the Collector may cancel the assessment and make another assessment instead as the Collector may consider proper, and any reference in the Ordinance to an assessment includes an assessment so made instead. This provides an alternative remedy for the aggrieved party without the need to lodge a formal appeal to the court under section 14 of the Ordinance.

38. Where the liable person has paid an amount purporting to be the stamp duty for the instrument, if the amount is less than the amount that would have been chargeable on the instrument as assessed by the Collector, and the difference is not paid by the expiry of 1 month from the date on which the assessment is made, the person is liable to pay to the Collector an additional stamp duty of an amount equal to interest on the amount of the outstanding duty at the rate of 4 cents per $100 (or part of $100) per day for the period beginning on the expiry of the 1 month period and ending on the date of the full payment of the outstanding duty and additional stamp duty.

39. The imposition of additional stamp duty does not relieve the person of his liability to any outstanding duty and penalty to which the person would otherwise be liable. However, the Collector may remit the whole or any part of any additional stamp duty taking into account the circumstances of each case.
**Notification requirement**

40. Where a claim for relief from stamp duty has been made for any instrument in relation to an IA transaction or the modifications to section 29CA or 29DA of the Ordinance, alleging that -

(a) an arrangement (alleged qualified IA) in a scheme (alleged specified ABS) is a qualified IA in a specified ABS; and

(b) particular persons are the O and the BI under the alleged specified ABS (the alleged O and the alleged BI),

if an IA disqualifying event occurs in relation to the alleged specified IA, the alleged O and the alleged BI under the alleged specified ABS must inform the Collector, in writing, of the IA disqualifying event within 30 days after the event occurs. Failing this, the alleged O and the alleged BI are liable to a penalty equal to the amount of fine at level 2 shown in Schedule 8 to the Criminal Procedure Ordinance (Cap. 221). The Collector will accept the written notification made by either the alleged O or the alleged BI as the full compliance with this requirement by both parties.

41. Nevertheless, an IA disqualifying event in relation to the alleged specified IA is not required to be notified if –

(a) either the relief concerned is denied, or because of an earlier IA disqualifying event in relation to the alleged specified IA, the relief granted for an instrument is deemed to be withdrawn;

(b) an assessment of the stamp duty payable for the instrument has been made under section 13 or 47L of the Ordinance; and

(c) either the assessment has become final and conclusive, or the denial or deemed withdrawal of the relief has been confirmed by the court on appeal.
ADJUDICATION

42. Under the Ordinance, an instrument is not duly stamped unless it is stamped with the stamp duty with which it would, but for the relief, be chargeable; or it has, in accordance with section 13 of the Ordinance, been stamped with a particular stamp or by way of a stamp certificate, denoting either that it is not chargeable with any stamp duty or that it is duly stamped.

43. In order to enable the Collector to determine if a BA or a specified IA in a specified ABS is qualified for stamp duty relief, the alleged O or the alleged BI who claims the relief is required to provide the executed instruments (e.g. agreement for sale, conveyance on sale, bought and sold notes, instrument of transfer and lease agreement) and certified true copies of such instruments for adjudication. The alleged O or the alleged BI is also required to provide a detailed description of the scheme that has been implemented and the type of documents that has been executed together with an explanation as to why it is considered that the scheme fulfills all specified requirements. Appendix 11 sets out the specific information required.

44. If the relief is granted to instruments in relation to an IA transaction, the instruments that have been stamped under section 13(2) will be endorsed to the effect that no stamp duty is chargeable thereon. Further, if the relief is granted under the modifications to section 29CA or 29DA of the Ordinance, the Collector will not impose any SSD or will impose SSD at a lesser amount on the instrument. If the relief is denied, the Collector will impose stamp duty on the instruments and, penalty, if the instruments are not presented for adjudication within the time for stamping.

RECORD KEEPING

45. Each person who is granted relief from stamp duty as the O or the BI (specified person) under an alleged qualified IA in an alleged specified ABS –

(a) must keep proper and sufficient books and records in the English or Chinese language of transactions, acts, operations to which the alleged specified ABS, or any arrangement in it,
relates so as to enable determinations under the Ordinance to be made; and

(b) must retain the books and records for a period of not less than 1 year after the end of the specified term of the alleged specified ABS.

46. The determinations under the Ordinance include a determination as to -

(a) whether to grant relief from stamp duty for an instrument in relation to an IA transaction or under the modifications to section 29CA or 29DA of the Ordinance, or whether such relief is deemed to be withdrawn; or

(b) whether an IA disqualifying event has occurred in relation to the alleged specified ABS.

47. Any specified person who fails to comply with the record keeping requirement is liable to a penalty at level 2 which is recoverable by the Collector as a civil debt due to the Government. However, a specified person is not required to keep the records under the following circumstances:

(a) the relief is deemed to be withdrawn under section 47H and the assessment of stamp duty so payable has become final and conclusive under section 47L(3) or the deemed withdrawal of the relief has been confirmed by the court on appeal;

(b) the Collector has specified that the books or records need not be kept by the specified person; or

(c) the person as a body corporate has ceased to exist.

REPORTING

48. For the purposes of making a determination mentioned in paragraphs 45 and 46 above, the Collector may give notice in writing to a specified person, requiring that person to furnish a return within a reasonable time stated in the
notice; or at any time intervals stated in the notice. Besides, the Collector may specify in the notice the information relating to the alleged specified ABS, or any arrangement in it, to be contained in the return; and the form in which the return is to be furnished.

49. Generally, a specified person is required to file the return of specified ABS transactions to the Stamp Office for the 6 months period ending on 30 June or 31 December within 1 month thereafter. The Collector has prescribed the return at Appendix 12 which is to be used for the reporting. A slight modification of the layout to suit the particular needs would be accepted provided that all the particulars and items contained therein are included in the modified form used.

50. A person who fails to comply with the reporting requirements is liable to a penalty at level 2, which is recoverable by the Collector as a civil debt due to the Government.

COMPLIANCE CHECKS

51. To ensure proper compliance, the Collector or his duly authorised officers may conduct compliance checks, including desk audits and inspections, to verify the correctness of the ABS returns and the entries in the books of accounts.

Offence in respect of false or misleading information

52. Where a person causes or allows –

(a) any entry to be made in the books and records kept as described in paragraph 45 above; or

(b) any particular to be furnished in a return;

and the entry or particular is false or misleading with intent to defraud the Government of any stamp duty, the person commits an offence and is liable for the fine at level 6 and to imprisonment for 1 year as specified in section 60 of the Ordinance.
Appendix 1

Diagram illustrating the key features of ABS structured on the basis of lease arrangement (Ijara)

At the start of ABS term

By the end of ABS term
Diagram illustrating the key features of ABS structured on the basis of profits sharing arrangement (Musharaka and Mudaraba)

* For Musharaka, the originator contributes in cash or in kind or both
For Mudaraba, the originator contributes expertise and management skills
Diagram illustrating the key features of ABS structured on the basis of purchase and sale arrangement (Murabaha)

At the start of ABS term

By the end of ABS term
Appendix 4

Diagram illustrating the key features of ABS structured on the basis of agency arrangement (Wakala)

At the start of ABS term

- Bond-holders receive bond proceeds
- Bond-issuer receives alternative bonds
- Originator acquires specified asset at acquisition cost (bond proceeds)
- Seller appoints originator as agent

By the end of ABS term

- Bond-holders redeem alternative bonds
- Bond-issuer receives specified return
- Originator receives agency fee or incentive fee
- Seller receives proceeds of disposal
- Buyer receives specified asset
- Specified asset of disposal
- Pool of specified assets
Appendix 5

Examples illustrating the Stamp Duty Relief on Qualified IA

Example 1 *(Lease arrangement)*

An originator *(O)* sets up an SPV *(BI)* for the purpose of issuing $100 million of alternative bonds to third party investors *(BH)*. BI uses the whole bond proceeds to buy a residential property in Hong Kong from O. BI makes a declaration of trust stating that it holds the property in trust for BH. BI then leases the property back to O. The rental income arising under the lease is used by BI to fund the distributions to BH. O signs a purchase undertaking in favour of BI, committing itself to repurchase the property from BI at the end of 5 years or on early termination of term at a price of $100 million.

In the above arrangement, if all specified conditions mentioned in paragraphs 9, 10 and 23 of this Practice Note are met, the following documents are not chargeable with stamp duty:

(a) The sale and purchase agreement/assignment executed between O and BI for the transfer of the property from O to BI;

(b) The declaration of trust made by BI in favour of BH;

(c) The lease agreement between BI and O;

(d) The undertaking signed by O to repurchase the property from BI; and

(e) The sale and purchase agreement/assignment executed between BI and O for the disposal of the property by BI to O.
Example 2 (Profits sharing arrangement)

O sets up an SPV (BI) to issue $100 million of 5-year alternative bonds to third party investors (BH). BI enters into a profits sharing arrangement with O, pursuant to which, BI and O agree to form a BU. BI contributes $100 million bond proceeds and O contributes all of its rights, benefits and interests to use certain real estate and properties that have a valuation. The BU is not incorporated. To effect the arrangement, BI’s name was added as one of the co-owners of the real estate and properties.

O also acts as a management agent overseeing the operations of the BU. Each of BI’s and O’s entitlement to the assets of the BU is undivided (each ranking pari passu without preference) and constitutes units. BI and O hold 49 units and 51 units respectively. O executes a purchase undertaking in favour of BI. Under the purchase undertaking, O irrevocably undertakes that upon maturity of the alternative bonds, O purchases BI’s 49 units in the BU at a price equal to the dissolution distribution amount.

In the above arrangement, if all specified conditions mentioned in paragraphs 9, 10 and 23 of this Practice Note are met, the following documents are not chargeable with stamp duty:

(a) The assignment executed to add BI as one of the co-owner of the real estate and properties; and

(b) The assignment executed to delete BI as one of the co-owners of the real estate and properties upon the dissolution of the qualified IA.

If the BU is a body corporate, the contract notes and instrument of transfer in respect of the transfer of interest in the BU from BI to O at the end of the term would not be chargeable with stamp duty.
Example 3 (Agency arrangement)

O sets up an SPV (BI) to issue $100 million of alternative bonds with a 3-year term to BH. BI enters into an agency arrangement with O whereby BI appoints O as agent. Under the arrangement, BI uses the bond proceeds ($100 million) to acquire a portfolio of quoted shares listed on the Hong Kong Stock Exchange from O and is to hold them as specified asset until the end of the specified term. O undertakes to manage the portfolio of shares, which may include the disposal and acquisition of new shares, for the purposes of producing income or gains. O is entitled to a management fee per annum plus any profits in excess of the specified return. If the profits are less than the specified return or if any loss is incurred, O is required to make up any shortfall in the specified return. O also executes a unilateral irrevocable purchase undertaking to purchase the portfolio of shares from BI at a price of $100 million plus any accrued portion of the specified return from BI immediately before the termination of the arrangement.

In implementing the arrangement, O transfers the dividends and gains on disposal of any shares to a profits reserve account. The profit return will be used to pay O itself the annual fee, make payments to BI to enable BI to meet the payments of the half-yearly distributions and the premium to BH, etc. Any profit in excess after the termination of the arrangement will be retained by O as an incentive fee.

In the above arrangement, if all specified conditions mentioned in paragraphs 9, 10 and 23 of this Practice Note are met, the following documents are not chargeable with stamp duty:

(a) The contract notes and instrument of transfer made for the sale and purchase of the quoted shares between BI and O at the commencement of the term; and

(b) The contract notes and instrument of transfer made for the sale and purchase of the quoted shares between BI and O upon the termination of the arrangement.
Appendix 6

Examples illustrating the Special Stamp Duty Relief on Qualified IA

Example 1

An originator (O) sets up an SPV (BI) for the purpose of issuing $100 million of alternative bonds to third party investors (BH). On 1.8.2013, BI entered into an agreement to buy from O a residential property in Hong Kong which was acquired by O on 1.9.2010. The purchase cost was funded by the bond proceeds. On the same date, BI made a declaration of trust stating that it held the property in trust for BH; and O signed a purchase undertaking in favour of BI, committing itself to repurchase the property from BI at the end of 5 years or on early termination of term at a price of $100 million. BI then leased the property back to O. The rental income arising under the lease was used by BI to fund periodic distributions to BH. The alternative bonds were fully redeemed on 31.7.2014 and the property was repurchased by O on 31.7.2014 for immediate disposal to a third party for $120 million.

In the above arrangement, if all specified conditions mentioned in paragraphs 9, 10 and 23 of this Practice Note are met, for the purpose of ascertaining the SSD liability, the transaction between BI and O will be disregarded. Besides, no SSD is payable in relation to the disposal of the property by O on 31.7.2014 since, according to the modifications to section 29CA or 29DA of the Ordinance, the date when the property was first acquired by O on 1.9.2010 will be regarded as the date on which O acquired the property, which was before 20.11.2010 (the date when SSD was introduced).
Example 2

*Same as example 1 but O acquired the residential property on 1.10.2012.*

Following Example 1, if all specified conditions mentioned in paragraphs 9, 10 and 23 of this Practice Note are met, for the purpose of ascertaining the SSD liability, the transaction between BI and O will be disregarded. In this case, for calculating the SSD liability on the disposal of the property by O to a third party on 31.7.2014, the date on which O first acquired the property, i.e. 1.10.2012, will be regarded as the date when the property was acquired by O. As the property has been held by O for more than 12 months but within 24 months, the SSD payable is $6 million (i.e. $120 million x 5%).

Example 3

*Same as example 1 but O acquired the residential property on 1.11.2012.*

Following Example 1, if all specified conditions mentioned in paragraphs 9, 10 and 23 of this Practice Note are met, for the purpose of ascertaining the SSD liability, the transaction between BI and O will be disregarded. In this case, for calculating the SSD liability on the disposal of the property by O to a third party on 31.7.2014, the date when the property was first acquired by O on 1.11.2012 will be regarded as the date on which O acquired the property. As the property has been held by O for more than 12 months but within 36 months, the SSD payable is $12 million (i.e. $120 million x 10%).
Appendix 7

Examples illustrating the operation of sections 29CA(4) and 29DA(4) as modified by Schedule 6

Example 1 (modified sections 29CA(4)(a) and 29DA(4)(a))

*Company A entered into an agreement for sale on 1.8.2013 to buy from a third party a piece of land with an existing building. Company A demolished the building. Company A as the originator (O) set up an SPV (BI) to issue alternative bonds to third party investors (BH). BI entered into a profits sharing arrangement with O, pursuant to which, BI and O formed a business undertaking (BU). BI contributed the bond proceeds and Company A as the O contributed the land to BU. BU constructed a new building on the land for disposal of the new property units to third party buyers. On the termination of the scheme, BU transferred the unsold units to O. O then sold the property units to third party buyers within 6 months from the acquisition.*

If all specified conditions mentioned in paragraphs 9, 10 and 23 of this Practice Note are met, the disposal of the unsold units by O to third party buyers is not subject to SSD as the construction on the land is taken as carried out by O.
Example 2 (modified sections 29CA(4)(b) and 29DA(4)(b))

A bond issuer (BI) under a specified alternative bond scheme entered into an agreement for sale on 1.8.2013 to buy from a third party a piece of land with an existing building. BI demolished the building and transferred the bare site to the originator (O). O then sold the bare site to a third party buyer within 6 months from the acquisition.

If all specified conditions mentioned in paragraphs 9, 10 and 23 of this Practice Note are met, the disposal of the bare site by O to third party buyer is not subject to SSD as the land with the then existing building is deemed to have been acquired by O and the demolition of that building is taken as carried out by O.
Appendix 8

Example illustrating the Security Demanded in relation to a Qualified IA

Example (Security)

An originator (O) sets up an SPV (BI) for the purpose of issuing $100 million of alternative bonds with a 5-year term to third party investors (BH). On 1.8.2013, BI entered into an agreement to buy from O a residential property in Hong Kong (Property 1) which was acquired by O on 15.10.2012. The purchase cost was funded by the bond proceeds. On the same date, BI made a declaration of trust stating that it held Property 1 in trust for BH; and O signed a purchase undertaking in favour of BI, committing itself to repurchase Property 1 from BI at the end of 5 years or on early termination of term at a price of $100 million. BI then leased the property back to O at a monthly rent of $100,000 for 5 years. The rental income arising under the lease was used by BI to fund periodic distributions to BH.

On 1.10.2013, O and BI agreed to cancel the undertaking in respect of Property 1 and replace Property 1 with another residential property (Property 2) which was acquired by O on 1.9.2013. On 1.10.2013, BI made a declaration of trust stating that it held Property 2 in trust for BH; and O signed a purchase undertaking in favour of BI, committing it to repurchase Property 2 from BI at the end of the term or on early termination of term at a price of $100 million. BI then leased Property 2 back to O at a monthly rent of $100,000 for 4 years and 10 months.

On 1.1.2014, O sold Property 1 to a third party for $120 million. The alternative bonds were fully redeemed on 31.7.2015 and Property 2 was repurchased by O on 31.7.2015 for immediate disposal to a third party for $130 million.

In the above arrangement, if all specified conditions mentioned in paragraphs 9, 10 of this Practice Note are met and the relevant instruments are submitted for adjudication within 30 days after execution, to be entitled to the stamp duty relief, security has to be provided to the Collector as required under paragraph 23 to cover the stamp duty on the relevant instruments as follows:
Property 1

(a) AVD of $8,500,000\(^{(1)}\), BSD of $15,000,000\(^{(2)}\) and SSD of $10,000,000\(^{(3)}\) on the sale and purchase agreement executed between O and BI on 1.8.2013 for transfer of Property 1 from O to BI;

(b) Stamp duty of $12,000\(^{(4)}\) on the lease agreement between BI and O;

(c) AVD of $8,500,000, BSD of $15,000,000 and SSD of $20,000,000\(^{(5)}\) on the undertaking signed by O on 1.8.2013 to repurchase Property 1 from BI.

Property 2

(d) Stamp duty of $12,000\(^{(6)}\) on the lease agreement between BI and O;

(e) AVD of $8,500,000\(^{(7)}\), BSD of $15,000,000 and SSD of $20,000,000 on the undertaking signed by O on 1.10.2013 to repurchase Property 2 from BI (may be set-off by the security given on the stamp duty in (c) upon the cancellation of the undertaking in respect of Property 1).

Notes:

(1) $100 million x 8.5% (scale 1 of AVD rates applies to conveyance on sale or agreement for sale executed on or after 23 February 2013)

(2) $100 million x 15%

(3) $100 million x 10% (property disposed of more than 6 months but within 12 months after acquisition)

(4) $100,000 x 12 x 1%

(5) $100 million x 20% (the applicable SSD rate for property acquired on or after 27 October 2012 and disposed of within 6 months after acquisition)

(6) $100,000 x 12 x 1%

(7) $100 million x 8.5%

(8) Since no equality money is paid for the agreement to replace Property 1 by Property 2, which is regarded as an agreement for exchange, no liability to stamp duty arises.

(9) The security given in respect of Property 1 will only be released after the expiry of the specified term.
Appendix 9

Sample Bank Guarantee

Guarantee for Payment of Stamp Duty

Date

To: Collector of Stamp Revenue
   Hong Kong

IN CONSIDERATION of and as a condition of your agreeing to grant relief that *stamp duty is not chargeable pursuant to section 47F of the Stamp Duty Ordinance (Cap. 117) (“the Ordinance”) / special stamp duty is not chargeable pursuant to section 47G of the Stamp Duty Ordinance (Cap. 117) (“the Ordinance”) / less special stamp duty is chargeable pursuant to section 47G of the Stamp Duty Ordinance (Cap. 117) (“the Ordinance”);

WE, [name of the Bank] HEREBY GUARANTEE the payment to you of the sum of ____________ (“the Sum”) being the whole or part of the *stamp duty / special stamp duty which will become payable to you, if the relief granted under section *47F / 47G of the Ordinance is deemed withdrawn under section 47H of the Ordinance, by:

(A) *(for relief granted under section 47F of the Ordinance)
   the parties to the following instruments, namely (specify the nature and date of each instrument):
   (a) ______________________
   (b) ______________________

(B) *(for relief granted under section 47G of the Ordinance)
   the vendor under the agreement or the transferor under the conveyance executed between (name of vendor/transferor) and (name of purchaser/ transferee) dated ________.

AND WE DECLARE that if the Sum is not paid to you within 30 days after the occurrence of the IA disqualifying event / (when there are two or more IA disqualifying events) the earliest IA disqualifying event as defined under section 47D(4) of the Ordinance, then,
without prejudice to the penalty payable under section *47H(3)(a) / 47H(3)(b) of the Ordinance, the Sum shall be due and payable by ourselves to you at the expiration of seven days after delivery of written notice to us by registered mail requiring payment of the Sum.

AND WE FURTHER DECLARE that if we fail to make payment of the Sum to you within fourteen days of the delivery of such written notice, the Sum shall then become recoverable by you against ourselves without any further demand or notice.

This guarantee is not transferable or assignable and is not revocable without your consent.

Signed by ___________________________ (Name of signatory)
for and on behalf of (name of the Bank) (Seal of the Bank)
Business Registration Number of Guarantor: (BRN of the Bank)
Address of Guarantor: (address of the Bank)

*Delete as appropriate

Note: Where there is a time limit set for the guarantee, the valid period of the guarantee should not be shorter than 30 days after the expiry of the specified term of the specified alternative bond scheme (as such terms are defined under Schedule 17A to the Inland Revenue Ordinance (Cap.112)).
Appendix 10

Examples illustrating the stamp duty liability on transfer of alternative bonds after the occurrence of disqualifying event

Example 1

On 1.9.2013, an originator (O) set up an SPV (BI) for the purpose of issuing $100 million of 5-year alternative bonds to third party investors (BH). BI used the whole bond proceeds to buy a residential property in Hong Kong from O. BI made a declaration of trust stating that it held the property in trust for BH. BI then leased the property back to O. On 1.8.2014, the alternative bond scheme failed to comply with the reasonable commercial return condition.

From 1.8.2014 onwards, the stamp duty relief on the transfer of the alternative bonds will be withdrawn. The transfer of any of the alternative bonds will amount to a transfer of the corresponding interest in the underlying asset, that is, the residential property. The transfer instrument will fall into the definition of chargeable agreement for sale which is chargeable with stamp duty, including buyer’s stamp and special stamp duty, if applicable, under head 1 in the First Schedule to the Ordinance. The amount of stamp duty payable is calculated by reference to the denomination of the transferred alternative bonds or value of the corresponding interest in the underlying asset, whichever is the higher.
Example 2

On 1.9.2013, an originator (O) set up an SPV (BI) to issue $100 million of alternative bonds with a 3-year term to BH. BI entered into an agency arrangement with O whereby BI appointed O as agent. Under the arrangement, BI used the bond proceeds ($100 million) to acquire a portfolio of quoted shares listed on the Hong Kong Stock Exchange from O and held them as specified asset until the end of the specified term. O undertook to manage the portfolio of shares and was entitled to a management fee per annum plus any profits in excess of the specified return. On 1.8.2014, the alternative bond scheme failed to comply with the reasonable commercial return condition.

From 1.8.2014 onwards, the stamp duty relief on the transfer of the alternative bonds will be withdrawn. The transfer of any of the alternative bonds will amount to a transfer of the corresponding interest in the underlying assets, that is, the Hong Kong stock. The transfer document will be chargeable with stamp duty under head 2 in the First Schedule to the Ordinance. The amount of stamp duty payable is calculated by reference to the denomination of the transferred alternative bonds or value of the corresponding interest in the underlying assets, whichever is the higher.
Appendix 11

Information and documents to be supplied
in respect of a specified Alternative Bond Scheme for adjudication

(1) Describe with sufficient details: -

(a) the structure of the scheme (with a diagram);

(b) the economic effect that the scheme intends to achieve; and

(c) the identity of all the parties involved in the scheme, the functions performed by each of them under the terms of the scheme and the economic functions performed by each of them, if different.

(2) Submit a copy of the offering circular or prospectus or other issuing document in respect of the alternative bonds (or instrument bearing other names) to be issued under the scheme.

(3) Confirm whether the scheme forms part of an issuance programme, and if so, provide a copy of the documentation of the issuance programme.

(4) Explain why it is considered that the scheme is an alternative bond scheme and a specified alternative bond scheme as defined under section 47C of the Stamp Duty Ordinance (the Ordinance), which has the same meaning as they have in Schedule 17A to the Inland Revenue Ordinance (the IRO).

(5) Confirm whether the issuer is a special purpose vehicle within the meaning of sections 1 and 3(1) of Schedule 17A to the IRO.

(6) Identify who is the Originator (the O) of the scheme as defined under section 47C of the Ordinance, which has the same meaning as it has in section 2(4) of Schedule 17A.

(7) If the investment arrangement is a profits sharing arrangement within the meaning of section 7 of Schedule 17A to the IRO, submit a copy of the partnership/joint venture agreement, if any, between the Bond Issuer (the BI) and the O of the scheme.
(8) If the investment arrangement is an agency arrangement within the meaning of section 9 of Schedule 17A to the IRO, submit a copy of the agency agreement between the BI and the O of the scheme and the documentation of the specified investment criteria, if any.

(9) List the transaction instruments which have been/will be executed for the scheme and briefly describe each instrument.

(10) In addition to (7) and (8) above, submit a copy of all the transaction instruments including sale and purchase agreement, deed of assignment, lease agreement, service agreement, management agreement, purchase undertaking, sale undertaking, substitution undertaking, declaration of trust and trust deed, if any, etc.

(11) List which transaction instrument(s) are further and in addition to those executed in an economically equivalent conventional financing scheme. Provide the rationale for entering into such additional transaction(s) with supporting evidence and state the economic effect each additional transaction intends to achieve.

(12) Confirm whether and show how the scheme will comply with each of the following conditions throughout the specified term of the scheme: -

(a) the reasonable commercial return condition;
(b) the BA as financial liability condition;
(c) the Hong Kong connection condition;
(d) the maximum term length condition; and
(e) the arrangements performed according to terms condition.

(13) Confirm whether and show how the scheme will comply with the following two additional conditions throughout the specified term of the scheme: -

(a) the BI as conduit condition; and
(b) the IA as financial liability condition.
(14) In respect of the modifications to section 29CA or 29DA of the Ordinance, state or submit

(a) the reference number allotted by the Collector on a claim for relief from stamp duty in respect of the specified ABS to which the modifications are related;

(b) a copy of the relevant instrument in support of the determination of the date of purchase
To: Collector of Stamp Revenue

RETURN OF SPECIFIED ALTERNATIVE BOND SCHEME
FOR THE PERIOD ENDED 30 JUNE / 31 DECEMBER ______

This return is furnished in accordance with section 47J of the Stamp Duty Ordinance, Cap. 117

Part A General information

(a) Name and address of the Originator: ______________________

(b) Name and Address of the Bond Issuer: ______________________

Part B Specified Alternative Bond Scheme

(a) Whether the Specified Alternative Bond Scheme complied with the maximum term length condition during the period: Yes / No*

(b) Whether the Specified Alternative Bond Scheme complied with the arrangements performed according to terms condition during the period: Yes / No*
   If No, specify the circumstances leading to the non-compliance of the condition: ______________

(c) Whether the Specified Alternative Bond Scheme complied with the Hong Kong connection condition during the period: Yes / No*

Part C Bond Arrangement

(a) (i) Amounts of Additional Payments to the bond-holders during the period: _____________ and the respective dates of payment: _____________________________

(ii) Amounts of Redemption Payment to the bond-holders during the period: _____________ and the respective dates of payment: _____________________________
   Whether the Additional Payments in (i) and the Redemption Payment in (ii) were made in accordance with the Offering Circulars: Yes / No*
(b) Whether the Bond Arrangement complied with the reasonable commercial return condition during the period: Yes / No*

(c) Whether the Bond Arrangement was treated as a financial liability of the Bond Issuer in accordance with Hong Kong Financial Reporting Standards/International Financial Reporting Standards during the period: Yes / No*

Part D  Specified Investment Arrangement

(a) Total amount of Investment Return during the period:
   (i) Specified Income/Specified Return/Markup (note) : _________________________________
   (ii) In respect of Lease Arrangement or Profits Sharing Arrangement, Specified Proceeds of Disposal: _________________________________
   (iii) In respect of Lease Arrangement or Profits Sharing Arrangement, Specified Acquisition Costs: _________________________________
   (iv) Other amount paid/payable by the Originator to the Bond Issuer: _________________________________
   (v) In respect of Profits Sharing Arrangement or Agency Arrangement, total amount of incentive fee and/or agency fee paid/payable by the Bond Issuer to the Originator: _________________________________

Note :  Within the meaning in Schedule 17A to the Inland Revenue Ordinance (Cap. 112). Lease Arrangement, see section 6(1)(c); Profits Sharing Arrangement, see section 7(1)(d); Purchase and Sale Arrangement, see section 8(2) &(4)(b); and Agency Arrangement, see section 9(1)(c)

(b) Whether any chargeable instrument for the Replacing Asset acquired during the period has not yet been submitted for adjudication: Yes / No*
   If yes
   Date of Replacement: __________________________________________
   Specified Acquisition Costs : _________________________________

(c) Whether security has not been provided for any chargeable instrument : Yes / No*
   If yes, date of instrument: _______________________________________

(d) Whether the Investment Arrangement complied with the BI as conduit condition during the period: Yes / No*

(e) Whether the Investment Arrangement was treated as a financial liability of the Originator in accordance with Hong Kong Financial Reporting Standards/International Financial Reporting Standards during the period: Yes / No*
Part E Declaration

I/We* declare that to the best of my knowledge and belief all the statements contained in this Return are true and correct. I/We* understand that heavy penalties may be incurred for furnishing a return which is false or misleading in any material respect.

Signature: __________________________ Date: __________________________
Name: __________________________ Company Chop: __________________________
Post: Director/Secretary/Manager/
      Precedent Partner/Proprietor __________________________

* Deletion where appropriate