Press Release

LCQ2: Imposing stamp duty on transactions of specified derivatives

Wednesday, January 20, 2016

Following is a question by the Hon Sin Chung-kai and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (January 20):

Question:

The Stamp Duty Ordinance provides that for each transfer of stocks, both the buyer and the seller must pay a stamp duty at a rate of 0.1% on the value of the transaction. However, transactions of specified derivatives, including derivative warrants (commonly known as "warrants") and callable bull/bear contracts, are exempted from the payment of stamp duty. In this connection, will the Government inform this Council:

(1) of the detailed justifications for the authorities' granting stamp duty exemption for the transactions of specified derivatives;

(2) of the respective percentages of the turnovers of derivative warrants, callable bull/bear contracts and other various specified derivatives in the total turnover of the securities market in each of the past three years; and

(3) whether it will, for the sake of complying with the principle of fairness, consider revoking the stamp duty exemption for the transactions of specified derivatives, so that investors are required to pay stamp duty for all types of securities transactions; if it will, of the details; if not, the reasons for that?

Reply:

President,

(1) Under the Stamp Duty Ordinance (SDO) (Cap. 117), the buyer and the seller each has to pay stamp duty in respect of instruments for transfer of Hong Kong stock.

"Hong Kong stock" is defined in the SDO to mean stock the transfer of which is required to be registered in Hong Kong, including any right, option or interest in respect of such stock.

If derivative products are settled by physical delivery, share transfers will be involved, and will therefore be chargeable to stamp duties. Generally speaking, if the holder of a derivative has no right to the underlying stock, the derivative will not be a "Hong Kong stock" as defined under the SDO, and its transfer will not be subject to stamp duty. At present, the trading of derivatives under the markets of the Hong Kong Exchanges and Clearing Limited (HKEx) is cash-settled and thus, it is not subject to stamp duty.

The Financial Secretary proposed in the 1997-98 Budget to encourage derivative trading by way of tax remission. Stamp duty payable on transactions in regional derivative warrants and convertible bonds had been remitted since April 1997. In 1998, the Stamp Duty (Amendment) (No.2) Ordinance 1998 (which, among other things, added section 19(1D) and the Fourth Schedule to the SDO) was enacted to replace the stamp duty remission arrangement at that time for transactions in regional derivative options and convertible bonds or notes with a specific exemption, so as to simplify the process for granting the concession, and extend such exemption to cover transactions in regional derivative warrants which had no more than 40% weighting by value in Hong Kong stocks.

(2) According to the information of the HKEx, the turnovers of derivative warrants and callable bull/bear contracts in 2013 were $1,783.3 billion and $1,269.2 billion respectively, accounting for 12% and 8% of the securities market's total turnover. In 2014, their respective turnovers were $2,044.5 billion and $1,230 billion, accounting for 12% and 7% of the securities market's total turnover. The turnover figures of 2015 were $4,504.7 billion and $1,836.9 billion, accounting for 17% and 7% of the securities market's total turnover.

(3) It is a common practice in international financial markets that derivative products are not subject to stamp duty. Major international derivative markets including the United States, the United Kingdom, Germany, Australia, Singapore and China all do not levy stamp duty on trading of derivative products.

As an international financial centre, Hong Kong must provide a competitive trading environment, including competitive transaction costs. As the product nature and trading purpose are different, unlike stock investors, derivative product investors do not have rights such as dividend payment and voting rights.

If derivative products are settled by physical delivery, share transfers will be involved, which is equivalent to trading on stocks. Thus, both cases will be subject to stamp duties, and this will not cause any unfairness to investors.

Ends