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Hong Kong Law

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## STAMP DUTY WAIVER FOR HK-LISTED ETFs EFFECTIVE FRIDAY, 13 FEBRUARY 2015

### Introduction

An extension of the current stamp duty exemption to transfers of shares or units of all Exchange Traded Funds (**ETFs**) listed on the Hong Kong Stock Exchange (the **Exchange**) will take effect on 13 February 2015 under the Stamp Duty (Amendment) Ordinance 2015 enacted by the Legislative Council on 3 February 2015.

The stamp duty exemption for Hong Kong ETFs is aimed at providing a further boost to the Hong Kong ETF market, which is already one of the largest in the Asia Pacific. The exemption currently applies to Hong Kong-listed ETFs whose registers of holders are maintained in Hong Kong that track indices comprising no more than 40% in Hong Kong stocks. That exemption is to be extended to all Hong Kong-listed ETFs, irrespective of the percentage of Hong Kong stocks in their portfolios. Originally proposed in the 2014-15 Budget, the waiver extension is aimed at encouraging ETFs tracking regional indices to list in Hong Kong.

ETFs are one of the fastest growing products in the asset management industry and Hong Kong ETFs had a record year in 2014 with turnover reaching a record high of HK\$1.2 trillion, up from HK\$903.1 billion in 2013.<sup>1</sup> The number of Hong Kong-listed ETFs has risen significantly in recent years: there are currently 144 listed ETFs compared with 69 at the end of 2010. The extension of the stamp duty exemption to all Hong Kong-

listed ETFs will reduce the transaction costs for investors in ETFs whose register of holders is maintained in Hong Kong and hold more than 40% in Hong Kong stocks. The move should enable Hong Kong to compete with jurisdictions such as Australia, Japan, Korea, Mainland China, Singapore, the UK and the United States, which do not impose stamp duty on transfers of shares or units in ETFs and so foster Hong Kong's development as a regional ETF hub and asset management centre.

### Hong Kong's ETF Market

Hong Kong's ETF market came into being in November 1999 with the launch of the Hong Kong Government's Tracker Fund of Hong Kong, which remains one of Hong Kong's most actively traded ETFs. The majority of Hong Kong's ETFs are equity, RQFII (Renminbi Qualified Foreign Institutional Investors) A-share and synthetic A-share ETFs. 2014 saw inflows from offshore investors in RMB-denominated ETFs as investors bet on a sustained rebound in the Shanghai Composite Index SSECOM after a prolonged slump. In December 2014, turnover of RQFII A-share and synthetic A-share ETFs accounted for 87.6% of total ETF turnover on the Exchange. A number of international ETF fund managers have listed ETFs in Hong Kong recently. For example, US-based Vanguard Investments has four ETFs listed on the Exchange and 2014 saw the first Canadian ETF fund manager issue ETFs in Hong Kong; BMO Asset Management (Asia) has three ETFs listed on the Exchange.

<sup>1</sup> Hong Kong Stock Exchange. News Release "HKEx Group Publishes Market Statistics 2014" at <http://www.hkex.com.hk/eng/newsconsul/hkexnews/2015/150108news.htm>. 8 January 2015

ETF is currently not a defined term under Hong Kong law but generally refers to open-ended collective investment schemes with shares or units listed or traded on the Exchange.

## Current Regime

Hong Kong-listed ETFs whose registers of holders are maintained in Hong Kong fall within the definition of “Hong Kong stock” under section 2 of the Stamp Duty Ordinance (Cap 117) (SDO)<sup>2</sup>. Accordingly stamp duty is payable on transfers of units or shares in such ETFs by both the buyer and seller at the rate of 0.1% of the value of the transaction. Relying on section 52 of the SDO, the Hong Kong government granted stamp duty remission to ETFs maintaining their registers of holders in Hong Kong which track indices comprising 40% or less in Hong Kong stocks to encourage ETFs to list in Hong Kong. Listed ETFs tracking indices comprising more than 40% in Hong Kong stocks however remain subject to stamp duty. Currently 26 Hong Kong-listed ETFs are subject to stamp duty. Stamp duty revenue from ETFs listed on the Exchange was HK\$100 million in 2013/14, approximately 0.45% of all the stamp duty collected on stock transactions.

## Justification for the Change

Although the number of Hong Kong-listed ETFs and their turnover has increased over the years, World Federation of Exchange statistics indicate that Hong Kong’s share of total ETF turnover in the Asia-Pacific region<sup>3</sup> has fallen by almost 13% in three years (from 30% in 2010 to 17% in 2013), suggesting that Hong Kong’s position as a regional ETF hub faces serious competition from other markets. The current regime also puts ETFs tracking Hong Kong stocks that are listed or traded in Hong Kong at a competitive disadvantage compared to similar ETFs which are listed on other markets, such as the New York Stock Exchange.

The government believes that a favourable tax regime should encourage more ETF listings in Hong Kong. Jurisdictions such as Australia, Japan, Korea, Mainland China, Singapore and the US no longer charge stamp duty on transactions of ETF shares or units, while the UK has stopped imposing stamp duty on UK domiciled ETFs.

<sup>2</sup> Under section 2 SDO, Hong Kong stock means stock the transfer of which is required to be registered in Hong Kong.

<sup>3</sup> Based on ETF turnover on the following 14 Asia-Pacific exchanges: the Australian Securities Exchange, Bombay Stock Exchange, Bursa Malaysia, the Hong Kong Stock Exchange, Indonesia Stock Exchange, Japan Exchange Group – Osaka Exchange, Japan Exchange Group – Tokyo Stock Exchange, Korea Exchange, National Stock Exchange of India, Shanghai Stock Exchange, Shenzhen Stock Exchange, Singapore Exchange, Taiwan Stock Exchange and the Stock Exchange of Thailand.

## Details of Amendments

A new Schedule 8 to the SDO sets out the types of transactions and transfers that are not chargeable to stamp duty by virtue of new section 19(1DA) of the SDO. They include:

- a sale or purchase of a share or unit of an ETF; and
- a transfer executed for a transaction by which the beneficial interest in a share or unit of an ETF passes otherwise than on sale or purchase.

“Exchange traded fund” is defined in Part 1 of the new Schedule 8 to mean an open-ended collective investment scheme the shares or units of which are listed or traded on a recognized stock market. “Collective investment scheme” has the same meaning given by Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571).

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