



→ International Law Firm Alliance  
**COMPENDIUM 2013**



## Hong Kong

### Foreign Investment

The Hong Kong Special Administrative Region ("HKSAR" or "Hong Kong") is receptive to foreign investment and does not discriminate between foreign and domestic investors. Attracting foreign investment is a priority of the government and is widely considered beneficial, even crucial, for Hong Kong's economic stability. It is quite common to have 100 per cent foreign investment in certain industries.

Hong Kong's predictable business environment, rule of law, stable and low tax regime, free flow of information and capital, good infrastructure and proximity to the People's Republic of China ("PRC") make it a desirable platform for investors. Hong Kong was named number one on the 2012 Index of Economic Freedom, compiled by The Heritage Foundation and The Wall Street Journal with a score of 89.9.

Foreign direct investment flows into Hong Kong exceeded US\$83 billion in 2011, an all-time high and up 17 per cent from 2010. Hong Kong currently ranks fourth globally in terms of foreign direct investment inflows, after the United States, PRC and Belgium and was second only to PRC in Asia. The city also topped the United Nations Conference on Trade and Development's Global Foreign Direct Investment Attraction Index 2011, an annual measure of an economy's success in attracting foreign direct investment.

#### **Hong Kong Basic Law regarding foreign investment**

The Basic Law of the HKSAR has provisions safeguarding Hong Kong's free enterprise system and liberal investment regime. Among other things, the Basic Law upholds the principles of a low tax policy, free convertibility of the Hong Kong dollar and free flow of capital.

**Business Entities available to foreign investors**

No distinction is made between foreign and domestic investors in terms of the types of business structures that may be used to carry on business in Hong Kong. Foreign investors may make use of all available forms of Hong Kong business entities.

Overseas companies that intend to establish an office in Hong Kong that do not wish to create a Hong Kong-incorporated subsidiary may register as non-Hong Kong companies under Part XI of the Companies Ordinance (Cap 32) (the "Companies Ordinance"). Hong Kong registered foreign corporations, with the exception of certain provisions, are not governed by the provisions of the Companies Ordinance. While the Companies Ordinance governs the formation and dissolution of Hong Kong companies, the creation and dissolution of a foreign corporation are governed by its respective law of place of incorporation.

Within one month after establishing a place of business in Hong Kong, an overseas incorporated company must register as a non-Hong Kong company under Part XI of the Companies Ordinance by registering certain documents with the Registrar of Companies and must obtain a business registration certificate from the Inland Revenue Department.

A non-Hong Kong company under Part XI of the Companies Ordinance must report to the Registrar of Companies any subsequent changes to its name, directors, secretaries, local representatives, memorandum and articles of association, the address of its principal places of business and registered office within one month of the change by submitting the prescribed forms. The creation of a charge on property situated in Hong Kong and any existing charge on acquired property situated in Hong Kong must be registered with the Registrar of Companies. Every year, a non-Hong Kong company must submit to the Registrar of Companies an annual return and a copy of its annual accounts (unless exempted). Such obligations will cease if the company ceases to have a place of business in Hong Kong.

**Directors**

Under the Companies Ordinance, a director can be of any nationality as long as he has attained the age of 18 and has not been disqualified from acting as a director. He can also be resident in Hong Kong or overseas. Therefore, he does not have to reside in Hong Kong when he is acting as a director. When a company appoints a director, the company must send a specific form to the Registrar of Companies of such appointment, the director's name and usual residential address and the number of his identity card or passport and include a statement signed by the director that he accepts the appointment and has attained 18 years of age.

Directors of companies owe a number of duties, which are based on the principle of showing the utmost good faith toward the company. Generally, director's duties are owed only to the company itself; directors have been held to owe fiduciary duties to individual shareholders only

in limited circumstances. Fiduciary duties of directors, which are generally based on equitable principles, mainly include:

- a duty to act in good faith in the interests of the company;
- a duty to exercise powers for a proper purpose for the benefit of members as a whole; and
- a duty to avoid conflicts of duty and interest.

Directors also owe a duty of skill and care to the company, which is not as onerous as directors' fiduciary duties.

Although the Companies Ordinance does not currently codify these directors' duties, which are derived from common law rules and equitable principles found in case law, directors can find guidance in "A Guide on Directors' Duties" issued by the Registrar of Companies and the "Guidelines for Directors" and the "Guide for Independent Non-Executive Directors" issued by the Hong Kong Institute of Directors. In addition to the general duties listed above, the Guide on Directors' Duties also includes the following general directors' duties:

- a duty not to delegate powers except with proper authorisation and duty to exercise independent judgement;
- a duty to exercise care, skill and diligence;
- a duty not to gain advantage from use of position as a director;
- a duty not to make unauthorised use of company's property or information;
- a duty not to accept personal benefit from third parties conferred because of position as a director;
- a duty to observe the company's memorandum and articles of association and resolutions; and
- a duty to keep proper books of account.

It should also be noted that the Companies Ordinance 2012, which is expected to come into effect in 2014, has codified directors' duties of care, skill and diligence. These standards will replace the existing common law rules and equitable principles. Directors of companies listed on the Stock Exchange of Hong Kong Limited (the "Exchange") must also comply with their obligations as directors of a listed company under the Exchange's Listing Rules and the Corporate Governance Code in Appendix 14 of the Listing Rules. Directors who do not perform their duties as a director may be liable to civil or criminal proceedings and may be disqualified from acting as a director.

### **Foreign investment incentives**

There are no specially enacted incentives for foreign investment. However, all foreign companies benefit from the Hong Kong government's policy of providing an appealing climate for investment. It promotes fair competition and does not discriminate between foreign and domestic investors.

Hong Kong generally has lower rates of tax than most other Asian jurisdictions and its tax environment is relatively simple.. In particular, there is:

- no tax on capital gains;
- no tax on profits arising in or derived from outside Hong Kong;
- no tax on dividends; and
- no estate duty.

There are three separate direct taxes which are levied under the Inland Revenue Ordinance (Cap. 112) (the "IRO"). The three taxes are: profits tax, salaries tax and property tax. The ambit of the IRO is limited territorially and it is only income with a Hong Kong source which, by and large, is subject to tax.

### Profits tax

Persons, including corporations, partnerships, trustees and bodies of persons carrying on any trade, profession or business in Hong Kong are chargeable to profits tax on the assessable profits arising in or derived from Hong Kong from such trade, profession or business. No distinction is made between residents and non-residents. A resident may therefore derive profits from abroad without being subject to tax; conversely, a non-resident may be chargeable to tax on profits arising in or derived from Hong Kong. Whether a business is carried on in Hong Kong and whether profits are derived from Hong Kong are largely questions of fact. However some guidance on the principles applied can be found in cases which have been considered by the courts in Hong Kong and in other common law jurisdictions.

### Tax rates

The tax rates for profits tax applicable to corporations are set out as follows:

| YEAR OF ASSESSMENT | TAX RATE |
|--------------------|----------|
| 2008/09 onwards    | 16.5%    |
| 2003/04 to 2007/08 | 17.5%    |
| 667 1/3            | 16%      |

The tax rates for profits tax applicable to unincorporated business are set out as follows:

| YEAR OF ASSESSMENT | TAX RATE |
|--------------------|----------|
| 2008/09 onwards    | 15%      |
| 2004/05 to 2007/08 | 16%      |
| 500 3/4            | 15.5%    |
| 667 1/3            | 15%      |

**Tax incentives and allowances**

In terms of tax incentives and allowances available in Hong Kong, no distinction is made between residents and non-residents. Foreign investors may make use of all types of tax incentives and tax allowances available in Hong Kong.

The tax incentives include (but are not limited to):

- Immediate writing off is allowed for capital expenditure on plant and machinery specifically and directly related to manufacturing processes, and on computer hardware and software.
- Capital expenditure on refurbishment of business premises is allowed to be written off over five years of assessment.
- There is an exemption from payment of tax on interest derived from any deposit placed in Hong Kong with an authorised institution (but this is not applicable to interest received by or accrued to a financial institution).
- Accelerated deduction for capital expenditure on specified environmental protection facilities from year of assessment 2008/09 and onwards. For machinery or plant, 100% deduction will be allowed for the capital expenditure incurred. For installations forming part of a building or structure, 20% deduction will be allowed for each year in five consecutive years.
- 100% deduction for capital expenditure on specified environmental-friendly vehicles from year of assessment 2010/11 and onwards.

In terms of tax allowances, generally all expenses to the extent to which they have been incurred in the production of chargeable profits are deductible. They include (but are not limited to):-

- Rent paid by any tenant of buildings or land occupied for the purpose of producing the assessable profits.
- Bad and doubtful debts (subject to certain rules).
- Repairs of premises, plant, machinery or articles etc. used in producing the profits.
- Expenditure for registration of a trademark, design or patent and expenditure on the purchase of patent rights or rights to any know-how for use in Hong Kong in the production of assessable profits.
- Expenditure on research and development (subject to certain rules).

■ Donations of an aggregate of not less than HK\$100 made to approved charities with the restriction that such donation shall not exceed 35% from year of assessment 2008/09 and onwards of the adjusted assessable profits.

### **Foreign investment restrictions**

As previously discussed, Hong Kong does not generally subject foreign investments to special regulatory regimes or requirements. However, there are restrictions in certain areas. For example, there are restrictions on voting control by non-Hong Kong residents and corporations in the broadcasting sector. The Hong Kong government considers that such restrictions are justified as the media has an extensive reach and the potential to influence a large proportion of the population.

### **Television broadcasting restrictions**

Pursuant to the Broadcasting Ordinance [Cap.562] ("BO"), an 'unqualified voting controller' (that is, a person who alone or with others, directly or indirectly, has the ability to control the exercise of the right to vote, who is not ordinarily resident in Hong Kong) is prohibited from holding or acquiring specified thresholds in aggregate of the total voting control of a domestic free television programme service licensee without the prior written consent of the Broadcasting Authority.

There are no equivalent restrictions on voting control by non-residents for domestic pay television programme service licensees or non-domestic television programme service licensees.

### **Sound broadcasting restrictions**

Pursuant to the Telecommunications Ordinance [Cap. 106] ("TO"), the aggregate of the voting shares in a sound broadcasting licensee in which 'unqualified persons' (that is, persons not ordinarily resident in Hong Kong) have, directly or indirectly, any right, title or interest, must not exceed 49 per cent of the total number of voting shares in the licensee. Under the TO, a licence will only be granted to or held by a "corporation that is:

- a company formed and registered in Hong Kong under the Companies Ordinance;
- not a subsidiary;
- empowered under its memorandum of association to comply fully with the provisions of the TO and the terms and conditions of its licence."

### **Capital Investment Entrant Scheme**

Hong Kong maintains a Capital Investment Entrant Scheme to facilitate the entry for residence by capital investment entrants (i.e., persons who make capital investments in Hong Kong but who would not be engaged in running a business in Hong Kong).

The Capital Investment Entrant Scheme (the "Scheme") commenced in October 2003 with the objective of allowing well-heeled people to take up residence in Hong Kong without needing to join in or establish an operating business. At this time, an entrant under the Scheme must have a HKD10 million qualifying investment, which excludes Hong Kong real property, in order to be eligible for admission to Hong Kong.

STATISTICS ON THE CAPITAL INVESTMENT ENTRANT SCHEME: Breakdown of the applicants under the Scheme (as at 31 March 2012)

|   | RECEIVED | APPROVAL -<br>IN-PRINCIPLE<br>GRANTED | FORMAL<br>APPROVAL<br>GRANTED |
|---|----------|---------------------------------------|-------------------------------|
| Foreign nationals   | 2438     | 106                                   | 1551                          |
| Macao SAR residents   | 388      | 21                                    | 294                           |
| Chinese nationals with<br>permanent residence<br>overseas             | 17368    | 1809                                  | 11935                         |
| Stateless persons with<br>permanent residence<br>in a foreign country | 3        | 0                                     | 3                             |
| Taiwan residents  | 507      | 15                                    | 339                           |
| TOTAL   | 20,704   | 1951                                  | 14122                         |

CAPITAL INVESTMENT ENTRANCE SCHEME REQUIREMENTS: An applicant for admission under the Scheme must:

- be aged 18 or above when applying for entry under the Scheme;
- have net assets of not less than HK\$10 million to which the applicant has been absolutely beneficially entitled for at least two years immediately prior to making the application;
- have invested within six months before submission of his application to the Immigration Department, or will invest within six months after the granting of approval in principle by the Immigration Department, not less than HK\$10million in permissible investment asset classes nominated for the Scheme programme (except Certificates of Deposit which must be invested within the latter period);
- have no adverse record in Hong Kong, his country of origin and present country of domicile (if different); and



■ be a Chinese national with permanent residence overseas, a foreign national (other than citizens of Cuba, Afghanistan and Democratic People's Republic of Korea), a resident of Macau or Taiwan or a stateless person with permanent residence in a foreign country with proven re-entry facilities.

**CONDITION OF STAY:** When approval in principle is given to an entrant, he will be initially allowed to enter Hong Kong on visitor status for three months. If evidence of active progress in investment can be shown, his visitor status can be extended for another three months. When the entrant has furnished proof that the requisite level of investment has been made, permission to stay for two years (formal approval) will be granted.

Further extensions for two years will be granted if the entrant can demonstrate to the satisfaction of the Immigration Department that he continues to meet the eligibility criteria and portfolio maintenance requirements. Further extensions for two years will be granted on the same basis. Upon completion of not less than seven years of continuous ordinary residence in Hong Kong, the entrant and his dependants may apply for the right of abode in Hong Kong in accordance with the law.

Entrants admitted under the Scheme are subject to a special condition of stay. If an entrant breaches any part of his Undertaking to the Immigration Department, he, together with his dependants, if any, would only be allowed to stay in Hong Kong for the remainder of his limit of stay or two months after the Director of Immigration has determined that he has breached the Undertaking, whichever is earlier.

**CAPITAL INVESTMENT ENTRANT SCHEME QUALIFYING INVESTMENTS:** Qualifying investments under the Scheme include investments in:

- equities/listed shares on The Stock Exchange of Hong Kong Limited and traded in Hong Kong Dollars;
- debt securities issued in Hong Kong Dollars by nominated government agencies;
- certificates of deposit issued by Hong Kong banks in Hong Kong Dollars and each for a minimum of twelve months deposit;
- subordinated debt issued by Hong Kong banks in Hong Kong Dollars; and
- eligible collective investment schemes as prescribed and authorised by the Hong Kong Immigration Department from time to time.

All permissible investment assets need to be held in a designated account in the applicant's own name and operated by a single financial intermediary and a contract has to be entered into between the financial intermediary and the applicant on terms which are set out by the Hong Kong Immigration Department.

The entire HK\$10 million investment is ring fenced for the life of the capital investment visa. The visa holder is not required to top up the HK\$10 million if the value of his portfolio drops nor

is he allowed to withdraw any increase in value. Any such increase must be reinvested if a choice is made to move between permissible asset classes.

FEES: The prescribed fee for a visa, entry permit, or extension of stay is HK\$160.

### **Exchange controls**

There are no restrictions on foreign exchange transactions, capital movement or repatriation of funds, nor special approval or notification requirements for foreign investments in Hong Kong.

## **→ Corporate Law**

The Companies Ordinance [Cap 32] (the “Companies Ordinance”) governs companies incorporated in Hong Kong and overseas companies registered in Hong Kong. Hong Kong’s first Companies Ordinance was enacted in 1865 and was based upon the UK Companies Act 1862. Since that time it has been revised to take account of changing practices in the commercial world and in particular the principles concerning transparency and disclosure of corporate transactions. The revisions are often similar to those introduced in other common law jurisdictions, such as Australia, Canada, Malaysia, New Zealand and Singapore, all of which adopted the UK corporate model. When interpreting its company law, Hong Kong courts may also refer to the cases decided in these jurisdictions.

All entities doing business in Hong Kong, regardless of their corporate forms, are required to obtain a business registration certificate from the Inland Revenue Department. Some are also required to register with the Companies Registry for incorporation. The application and registration procedures differ depending on whether the business is a sole proprietorship, a partnership (or other unincorporated body), a Hong Kong-incorporated company or an overseas company.

### **Sole Proprietorship or Partnership**

Sole proprietorships or partnerships are required to obtain a business registration certificate from the Inland Revenue Department, but beyond this there are few formalities with which they must comply. Whilst sole proprietorships and partnerships are not required to disclose information to the public, they must nevertheless keep accounts and are liable for profits tax.

Partnerships are governed by the Partnership Ordinance [Cap. 38]. Both sole proprietorships and partners are liable for the debts of their business with unlimited liability. Whilst partnerships may be formed under the Limited Partnership Ordinance [Cap. 37], in practice this ordinance is rarely used.

## Company

**LIMITED COMPANY INCORPORATED IN HONG KONG:** To incorporate a limited company in Hong Kong, certain documents must be filed with the Registrar of Companies and a business registration certificate must subsequently be obtained from the Inland Revenue Department. Limited companies are subject to continuing obligations (including the requirement to submit various documents to the Registrar of Companies such as annual accounts and details of loan capital and directors) set out in the Companies Ordinance.

In general, a company incorporated in Hong Kong must comply, inter alia, with the following continuing obligations:

- Maintenance of registers (including registers of members, charges, directors and secretaries);
- Maintenance of proper accounting records;
- Hold an annual general meeting at least once every calendar year (first general meeting must take place within 18 months after the company's incorporation);
- File with the Registrar of Companies an annual return within 42 days of the anniversary of its incorporation every year;
- Preparation by the company's directors of the annual accounts of the company and presentation of the profit and loss account before the annual general meeting;
- Preparation of an auditors' report and a directors' report to be attached to the annual accounts;
- Delivery of particulars of certain charges or security created to the Registrar of Companies; and
- Notification of the Registrar of Companies when there are changes in certain details and particulars.

All documents filed with the Registrar of Companies are open to public inspection.

**OVERSEAS COMPANY REGISTERED AS A NON-HONG KONG COMPANY IN HONG KONG:** Overseas companies that intend to establish an office in Hong Kong that do not wish to create a Hong Kong-incorporated subsidiary may register as non-Hong Kong companies under Part XI of the Companies Ordinance.

Within one month after establishing a place of business in Hong Kong, an overseas incorporated company must register as a non-Hong Kong company under Part XI of the Companies Ordinance by registering certain documents with the Registrar of Companies and must obtain a business registration certificate from the Inland Revenue Department.

A non-Hong Kong company registered under Part XI of the Companies Ordinance must report to the Registrar of Companies any subsequent changes to its name, directors, secretaries, local representatives, memorandum and articles of association, the address of its principal places of business and registered office within one month of the change by submitting the prescribed

forms. The creation of a charge on property situated in Hong Kong and any existing charge on acquired property situated in Hong Kong must be registered with the Registrar of Companies. Every year, a non-Hong Kong company must submit to the Registrar of Companies an annual return and a copy of its annual accounts (unless exempted). Such obligations will cease if the company ceases to have a place of business in Hong Kong.

### **Private companies**

Under the Companies Ordinance, a private company is a company that, according to its articles of association:

- restricts the right to transfer its shares;
- limits the number of its members to 50; and
- prohibits the company inviting members of the public to subscribe for its shares or debentures.

A private company need not file accounts with its annual return.

### **Public companies (non-listed)**

Any company which does not contain in its articles of association the three restrictions required for the establishment of a private company under the Companies Ordinance is a public company. A public company is subject to wider disclosure requirements than a private company, e.g. a public company must submit to the Registrar of Companies its annual audited financial statements which are open to inspection by the public. At the same time, a public company is subject to more stringent restrictions imposed by the Companies Ordinance than a private company.

### **Listed companies**

Listed companies in Hong Kong are companies listed on one of the two boards operated by the Stock Exchange of Hong Kong Limited (the "Exchange"), namely, the Main Board and the Growth Enterprise Market (the "GEM"). The Main Board caters for companies with a profitable operating track record or that are able to meet alternative financial standards. It is designed to give these companies an opportunity to raise further funds from the market in order to finance future growth. GEM, on the other hand, caters for smaller growth companies and has lower admission criteria. The majority of companies listed in Hong Kong are listed on the Main Board.

While a listing offers advantages and opportunities such as providing easier and greater access to new or additional capital, a listed company is subject to more stringent ongoing compliance obligations. In addition to the Companies Ordinance, listed companies are mainly governed by the rules governing the listing of securities on the Exchange (or the rules governing the listing of securities on GEM of the Exchange) as well as the Securities and Futures Ordinance (Cap 571).

**Limited companies**

The Companies Ordinance provides that limited companies can be either limited by shares or limited by guarantee.

**COMPANIES LIMITED BY SHARES:** The memorandum of association of a company limited by shares will specify the maximum number of shares that it may issue. Shares are usually fully paid when they are issued, in which case, even if the company is wound up and is unable to pay its debts, the members would not be liable to pay those debts. Liability of members of a company limited by shares will be limited to the nominal value of the shares, as already contributed.

Where shares have only been partly paid for on issue, however, a member is liable to pay the agreed balance according to the terms of issue or, if there are no terms, when called upon to do so. In the event of the company being wound up according to this scenario, the members may be liable to contribute towards paying the company's debts, but their maximum contribution will be the amount of the nominal value unpaid on their shares.

**COMPANIES LIMITED BY GUARANTEE:** The liability of the members of a company limited by guarantee is limited to the amount that they agree to contribute to its assets in the event of the company being wound up. The amount guaranteed by each member is specified in the company's memorandum. It is commonly used when there is no intention to distribute the company's profits to its members and the members therefore do not need to hold shares. Companies limited by guarantee are typically used by charities and quasi-charitable organisations such as schools and hospitals, but is only a suitable corporate form if the company does not need an initial share capital.

Any provision in the memorandum or articles of a company limited by shares or any resolution which purports to give any person a right to participate in its divisible profits, otherwise than as a member, will be void.

**COMPANIES WITHOUT LIMITED LIABILITY:** If a company is registered as unlimited, its members will be personally liable for the debts of the company without limit. Unlimited companies may be formed with or without a share capital. If the company is trading and intends to distribute profits, shares may be a useful method of measuring each member's interest in the company. If an unlimited liability company with a share capital goes into liquidation, the members will be liable to pay whatever price they agreed for their shares; where this amount is inadequate to satisfy the debts and liabilities of the company together with the costs of winding-up, the members must contribute rateably according to their shareholdings.

**DORMANT COMPANIES:** An inactive private company may pass and deliver to the Registrar of Companies a special resolution declaring that the company will become dormant. A company is eligible to apply for dormant status if, since the date of incorporation or any other specified

date, it has not entered into a “relevant accounting transaction”, as defined under the Companies Ordinance. Dormancy enables a private company to remain a registered company while at the same time being exempt from holding annual general meetings, preparing and filing annual reports and carrying out audits of its accounts. Thus, the cost of maintaining a dormant company can be significantly lower than the cost of maintaining an active company.

A dormant company may not enter into any transaction that should be entered into its books of accounts (a “relevant accounting transaction”) except the payment of certain fees. If a dormant company does enter into a “relevant accounting transaction” its members are liable for any debt or liability that arises from that transaction if they knew or ought reasonably to have known about it.

A company ceases to be deemed to be dormant upon delivery to the Registrar of Companies of a special resolution declaring that the company intends to enter into a “relevant accounting transaction”.

### **Share Capital**

The Companies Ordinance does not specify a minimum or maximum amount of authorised or issued share capital for either a public or a private company. Instead, a company’s memorandum of association must specify its authorised share capital, including how the total sum is divided into shares and the nominal value of each share. A company may issue shares with preferred, deferred, redemption or other special rights as specified in the memorandum and articles of association of the company. If a company issues only one type of shares, the shares are presumed to be ordinary shares.

Under the Companies Ordinance, Hong Kong companies must have at least one member and that one member may be a nominee of the beneficial owner. The member need not be resident in Hong Kong and can be an individual or a corporation. In Hong Kong, companies are typically incorporated with a share capital of HK\$10,000 divided into 10,000 shares of HK\$1 each.

### **Rights of Shareholders**

Although a company’s board of directors have the powers to manage a company and make day-to-day decisions, the Companies Ordinance reserves certain matters for the decision of a company’s shareholders. Decisions reserved for shareholders include:

- at an annual general meeting, declaring the rate of dividend to be paid on the shares of the company;
- at the annual general meeting, electing directors in place of those retiring;
- at the annual general meeting, appointing auditors for the forthcoming year;
- alterations to the company’s memorandum and articles of association;
- changing the name of the company;

- giving financial assistance for the purchase of the shares of the company;
- buying back the company's own shares;
- granting the directors power to allot shares;
- reducing the capital of the company;
- reconstructing the company's shareholding and debts;
- removing the company's directors from office; and
- petitioning the court to wind up the company.

**MINORITY SHAREHOLDER PROTECTIONS:** The Companies Ordinance provides for certain rights and protections for minority shareholders. Some of these protections include:

- certain decisions of a company requiring a special resolution also require the approval of the court (i.e. reduction in a company's share capital);
- minority shareholders may be able to apply to the court for cancelling certain decisions approved by a special resolution if the court considers the decision unfair;
- holders of 5 per cent of the paid up capital of the company may require the directors to convene an extraordinary general meeting;
- members who hold 2.5 per cent of the total voting rights of all members, or 50 members holding shares on which there has been paid up an average of HK\$2000 per member, may require a certain resolution to be added to the agenda for the company's next annual general meeting;
- 100 members, or the holders of 10 per cent of the company's shares, may apply to the Hong Kong Financial Secretary for the appointment of an inspector to investigate the affairs of the company;
- any member may apply to the court for a remedy if the affairs of the company are being conducted in a manner 'unfairly prejudicial' to the members;
- any member may bring an action in respect of misfeasance committed against a company; or any member may petition for the company to be wound up by the court.

## Directors

**REQUIREMENTS:** Public companies must have at least two directors. Private companies may have just one director. In the case of a private company that is not a member of a group of companies that includes a listed company, a body corporate can be appointed as a director. Under the Companies Ordinance, a director can be of any nationality, must have attained the age of 18 and must not have been disqualified from acting as a director. When a company appoints a director, the company must send a specific form to the Registrar of Companies of such appointment, the director's name and usual residential address and the number of his identity card or passport and a statement must be included that the director accepts the appointment and has attained 18 years of age. That statement must signed by the director.

**DUTIES OF DIRECTORS OF A COMPANY:** Directors of companies owe a number of duties, which are based on the principle of showing the utmost good faith toward the company. Generally,

directors' duties are owed only to the company itself; directors have been held to owe fiduciary duties to individual shareholders only in limited circumstances. Fiduciary duties of directors, which are generally based on equitable principles, mainly include:

- a duty to act in good faith in the interests of the company;
- a duty to exercise powers for a proper purpose for the benefit of members as a whole; and
- a duty to avoid conflicts of duty and interest.

Directors also owe a duty of skill and care to the company, which is not as onerous as directors' fiduciary duties.

Although the Companies Ordinance does not currently codify these directors' duties, which are derived from common law rules and equitable principles found in case law, directors can find guidance in "A Guide on Directors' Duties" issued by the Registrar of Companies and the "Guidelines for Directors" and the "Guide for Independent Non-Executive Directors" issued by the Hong Kong Institute of Directors. In addition to the general duties listed above, the Guide on Directors' Duties also includes the following general directors' duties:

- a duty not to delegate powers except with proper authorisation and duty to exercise independent judgement;
- a duty to exercise care, skill and diligence;
- a duty not to gain advantage from use of position as a director;
- a duty not to make unauthorised use of a company's property or information;
- a duty not to accept personal benefit from third parties conferred because of position as a director;
- a duty to observe the company's memorandum and articles of association and resolutions; and
- a duty to keep proper books of account.

It should be noted that the Companies Ordinance 2012, which is expected to come into effect in 2014, has codified directors' duties of skill, care and diligence. These standards will replace the existing common law rules and equitable principles. Directors of companies listed on the Exchange must also comply with their obligations as directors of listed companies under the Exchange's Listing Rules and the Corporate Governance Code in Appendices 14 and 15 of the Main Board and GEM Listing Rules, respectively. Directors who do not perform their duties as a director may be liable to civil or criminal proceedings and may be disqualified from acting as a director.

### **Dissolution of a company**

A company may be dissolved by the following methods:

- a court order to facilitate an amalgamation or reconstruction of companies;
- striking off the name of a company from the register of companies by the Registrar of Companies;
- deregistration of defunct private companies ; or
- a winding up.



**DEREGISTRATION OF DEFUNCT PRIVATE COMPANIES UNDER THE COMPANIES ORDINANCE:**

A private company may make application to the Registrar of Companies for deregistration in accordance with Section 291AA of the Companies Ordinance if :

- all the members of the company agree to the deregistration;
- the company has never commenced business or operation, or has ceased to carry on business or ceased operation for more than 3 months immediately before the application;
- the company has no outstanding liabilities; and
- the company has obtained a “no objection” notice from the Inland Revenue Department (the company applying for deregistration is required to prepare the final accounts up to the date of cessation of the business and file the final accounts with the Inland Revenue Department before obtaining a “no objection” notice. The final accounts should show that the company has no liabilities and should be prepared before the commencement of deregistration).

**WINDING UP:** A company may be wound up:

- by the court, i.e. a compulsory winding up; or
- voluntarily, either as:
  - a members’ voluntary winding up, or
  - a creditors’ voluntary winding up.

**COMPULSORY WINDING UP:** A company may be wound up by the court in the following circumstances:

- if a special resolution has been passed by the company that it should be wound up by the court;
- if the company does not commence its business within one year from its incorporation, or suspends its business for a whole year;
- if the company has no members;
- if the company is unable to pay its debts; a company is deemed to be unable to pay its debts if:
  - a creditor whose debt exceeds HK\$10,000 serves a notice on the company requiring payment and is not paid within three weeks;
  - an execution in favour of a creditor of the company is returned unsatisfied in whole or in part; or
  - the court is satisfied that the company cannot pay its debts, taking into account its contingent and prospective liabilities.
- if the memorandum or articles of association of the company provide that on the occurrence of certain events the company is to be dissolved, and such events occurred;
- if the company is being carried on for an unlawful purpose of any purpose lawful in itself but one which cannot be carried out by a company;
- if the court is of the opinion that it is just and equitable that the company should be wound up;
- if throughout a period of not less than six months ending on the date of the winding up petition the company has not had:

- in the case of a private company, at least one director, or
- in case of a public company, at least two directors; and
- a secretary.

■ if the company has failed to pay the annual registration fee payable under the Eighth Schedule to the Companies Ordinance; or

■ if the company has been persistently in breach of its statutory obligations.

**VOLUNTARY WINDING UP:** Section 228(1) of the Companies Ordinance provides that a company may be wound up voluntarily:

■ when the period, if any, fixed by the articles for the duration of the company expired, or an event which determines its existence occurs, and the company resolves (by ordinary resolution) to be wound up voluntarily;

■ if a special resolution has been passed by the company that it should be wound up voluntarily;

■ if a special resolution has been passed by the company that it cannot by reason of its liabilities continue its business and that it is advisable to wind it up; and

■ if the directors of the company or, in the case of a company having more than two directors, the majority of the directors, make and deliver to the Registrar of Companies a winding up statement under Section 228A of the Companies Ordinance.

A company can be dissolved by members' voluntary winding up only if it is solvent, i.e. it can settle all of its debts in full. If a company has been put into a members' voluntary winding up and the liquidators are subsequently of the opinion that the company will not be able to pay its debts in full within the period stated in the certificate of solvency, they must summon a meeting of the creditors and lay before the meeting a statement of the assets and liabilities of the company, i.e. the winding up is converted into a creditors' voluntary winding up.

### **Liability of the members of the company**

In the event of a company being wound up, every past and present member is liable to contribute to the assets of the company to an amount sufficient to pay:

- the debt and liabilities of the company;
- the costs, charges, and expenses of winding-up; and
- for the adjustment of rights between the members.

This statement of liabilities is qualified in relation to companies incorporated with limited liability:

■ in a company limited by shares, no contribution is required from any past or present member which exceeds the amount, if any, that is unpaid on his shares.

■ in a company limited by guarantee, no contribution is required which exceeds the amount which was undertaken to be contributed in the event of the company being wound up.

■ in a company limited by guarantee which has a share capital in addition to the amount undertaken to be contributed in the event of a winding-up, the members are liable to contribute to the extent of any sums unpaid on any shares they hold.

## **Directors with unlimited liability**

Although rarely used, the Companies Ordinance provides that the memorandum of a limited liability company may provide that the liability of its directors, managers, or managing director is unlimited. In such case, the directors will be personally liable for all of the company's debts. Before a person accepts an office in such a company, whether by election or by appointment, he must be given notice in writing that his liability will be unlimited.

If authorised by its articles of association, a limited company may also alter its memorandum to make the liability of its directors, managers, or managing director unlimited. Such alteration requires a special resolution. The directors or members of a company may also accept personal liability, for example, by guaranteeing a particular contract, which has the effect of that director losing the benefit of limited liability in that instance.

## **→ Labour Law**

### **Legislation**

The Employment Ordinance (Cap. 57) is the main piece of legislation governing employment in Hong Kong. All employees covered by the Employment Ordinance, irrespective of their hours of work, are entitled to basic protection under the Employment Ordinance. Parties may not contract out of the Employment Ordinance provisions and any agreement attempting to do so is void.

The Minimum Wage Ordinance (Cap. 608) establishes a statutory minimum wage regime aimed at striking a balance between preventing excessively low wages and minimising the loss of low-paid jobs, while sustaining Hong Kong's economic growth and competitiveness.

The Employees' Compensation Ordinance (Cap. 282) establishes a no-fault, non-contributory employee compensation system for work injuries. It obliges every employer to obtain an insurance policy in respect of its liability to compensate employees for such work injuries.

To provide retirement protection to the entire workforce in Hong Kong, the Mandatory Provident Fund Schemes Ordinance (Cap. 485) was launched in 2000.

There are also certain anti-discrimination laws in force in Hong Kong to prohibit discrimination on grounds such as sex, pregnancy, marital status, disability, family status and race.

### **Common Law**

Case law is used to interpret employment law legislation, explain and expand the tests and definitions and fill the gaps using common law principles. Whilst Hong Kong cases are binding

on Hong Kong courts, case law from other common law jurisdictions may be considered and have persuasive authority in Hong Kong.

## **Employment Ordinance**

APPLICATION OF THE EMPLOYMENT ORDINANCE: The Employment Ordinance applies to all employees with the following exceptions:

- a family member who lives in the same dwelling as the employer;
- an employee as defined in the Contracts for Employment Outside Hong Kong Ordinance;
- a person serving under a crew agreement under the Merchant Shipping (Seafarers) Ordinance, or on board a ship which is not registered in Hong Kong; and
- an apprentice whose contract of apprenticeship has been registered under the Apprenticeship Ordinance, except with respect to certain provisions of the Employment Ordinance.

All employees covered by the Employment Ordinance, irrespective of their hours of work, are entitled to basic protection under the Employment Ordinance including payment of wages, restrictions on wages deductions and the granting of statutory holidays, etc.

Employees who are employed under a continuous contract are further entitled to such benefits as rest days, paid annual leave, sickness allowance, severance payment and long service payment, etc.

## **Contract of Employment**

A contract of employment is an agreement on the employment conditions made between an employer and an employee. Employers and employees are free to negotiate and agree on the terms and conditions of employment provided that they do not violate the provisions of the Employment Ordinance. Any term of an employment contract which purports to extinguish or reduce any right, benefit or protection conferred upon the employee by the Employment Ordinance is void. Therefore, the Employment Ordinance will prevail if any contractual terms are less favourable than those provided for in the Ordinance.

## **Information on Conditions of Service**

Before employment begins, an employer must clearly inform each employee of the conditions of employment under which he is to be employed with regard to:

- wages (see definition below);
- wage period;
- length of notice required to terminate the contract; and
- if the employee is entitled to an end of year payment, the end of year payment or proportion and the payment period.

Whenever there is any change in the conditions of service, whether these have merely been proposed to an employee or are actually in force, the employer shall inform him in an intelligible manner.

## **Wages**

"Wages" means all remuneration, earnings, allowances, tips and service charges payable to an employee in respect of work done or work to be done. Allowances including travel allowances, attendance allowances, commission and overtime pay are within the definition of wages. However, wages do not include certain items such as accommodation or education etc. provided by the employer, the employer's contribution to any retirement scheme; non-recurrent travel allowance, commission or annual bonus which is of a gratuitous nature or paid at the discretion of the employer.

## **Minimum Wage Ordinance**

The Minimum Wage Ordinance provides a wage floor to protect grassroots employees. It came into effect on 1 May 2011 and the current statutory minimum wage rate ("SMW rate") is HK\$28 per hour. In essence, wages payable to an employee in respect of any wage period, when averaged over the total number of hours worked in the wage period, should be no less than the SMW rate

APPLICATION OF THE MINIMUM WAGE ORDINANCE: SMW applies to all employees, whether they are monthly-rated, daily-rated, permanent, casual, full-time, part-time or other employees, and regardless of whether or not they are employed under a continuous contract as defined in the Employment Ordinance, except for (i) persons to whom the Employment Ordinance does not apply; (ii) live-in domestic workers; and (iii) student interns as well as work experience students arranged or endorsed by an institution in connection with a non-local education programme.

AMOUNT OF MINIMUM WAGE: Wages payable to an employee in respect of any wage period must not be less than the amount of minimum wage calculated as follows:

$$\text{Minimum wage} = \frac{\text{Total number of hours worked}}{\text{by the employee in the wage period}} \times \text{SMW rate (i.e. \$28)}$$

## **Rest Days, Holidays and Leave**

An employee must be allowed to enjoy rest days, statutory holidays and paid annual leave during employment.

**REST DAYS AND STATUTORY HOLIDAY:** An employee employed under a continuous contract is entitled to at least one rest day in every seven days. While an employee may work voluntarily on a rest day, an employer must not compel an employee to work on a rest day except in cases of unforeseen emergency. An employer should grant his employee a statutory holiday, or arrange an “alternative holiday” or “substituted holiday”. “Buy-out” of a holiday is not allowed.

**PAID ANNUAL LEAVE:** An employee is entitled to annual leave with pay after having been employed under a continuous contract for every 12 months. An employee’s entitlement to paid annual leave increases progressively from seven days to a maximum of 14 days according to his length of service:

### **Sickness and Maternity Protection**

**SICK LEAVE:** An employee employed under a continuous contract is entitled to sickness allowance. An employer is prohibited from terminating the employment contract of an employee on his paid sickness day, except in cases of summary dismissal due to the employee’s serious misconduct.

**MATERNITY LEAVE:** A female employee, subject to certain qualifying requirements under the Employment Ordinance, is entitled to a continuous period of 10 weeks’ paid maternity leave. An employer is prohibited from dismissing a pregnant employee from the date on which she is confirmed to be pregnant by a medical certificate to the date on which she is due to return to work upon the expiry of her maternity leave.

### **End of Year Payment**

The provisions concerning end of year payment apply to an employee employed under a continuous contract who, in accordance with a term of his contract is entitled to an end of year payment from his employer. Such end of year payment means any annual payment (including double pay, 13th month payment, end of year bonus) of a contractual nature. It does not include any payment which is of a gratuitous nature or which is payable at the discretion of the employer.

### **Termination of Contract of Employment**

**TERMINATION OF EMPLOYMENT CONTRACT BY NOTICE OR PAYMENT IN LIEU OF NOTICE:** A contract of employment may be terminated by the employer or employee through giving the other party due notice or wages in lieu of notice. In the case of a continuous contract of employment, the length of notice or the amount of wages in lieu of notice required are:

TABLE 1

|                           | EMPLOYMENT CONDITIONS                     |   | LENGTH OF NOTICE                           | WAGES IN LIEU OF NOTICE |
|---------------------------|---|---|--|-------------------------|
|                           | Within the first month of probation       |   | Not required                               | Not required            |
| DURING PROBATION PERIOD   | After the first month of probation        | With agreement to the length of notice    | As per agreement, but not less than 7 days | Table 2                 |
|                           |   | Without agreement to the length of notice | Not less than 7 days                       | Table 2                 |
| NO/AFTER PROBATION PERIOD | With agreement to the length of notice    |   | As per agreement, but not less than 7 days | Table 2                 |
|                           | Without agreement to the length of notice |   | Not less than 1 month                      | Table 2                 |

TABLE 2

|  |   |   |                         |
|--|---|---|-------------------------|
| Notice period expressed in days or weeks | Average daily wages earned by an employee in the 12 month period preceeding the day when a notice of termination of contract is given   | Number of days in the notice period for which wages would normally be payable to the employee | Wages in lieu of notice |
| Notice period expressed in months        | Average monthly wages earned by an employee in the 12 month period preceeding the day when a notice of termination of contract is given | Number of months specified in the notice period   | Wages in lieu of notice |

**TERMINATION OF EMPLOYMENT CONTRACT WITHOUT NOTICE OR WAGES IN LIEU OF NOTICE:** An employer may summarily dismiss an employee without notice or payment in lieu of notice if the employee, in relation to his employment: (i) wilfully disobeys a lawful and reasonable order; (ii) misconducts himself; (iii) is guilty of fraud or dishonesty; or (iv) is habitually neglectful in his duties.

Taking part in a strike is not a lawful ground for an employer to terminate an employee's contract of employment without notice or payment in lieu.

*NOTE:* Summary dismissal is a serious disciplinary action. It only applies to cases where an employee has committed very serious misconduct or fails to improve after the employer's repeated warnings.

An employee may terminate his employment contract without notice or payment in lieu of notice if: (i) he reasonably fears physical danger by violence or disease; (ii) he is subjected to ill-treatment by the employer; or (iii) he has been employed for not less than five years and is certified by a registered medical practitioner or a registered Chinese medicine practitioner as being permanently unfit for the type of work he is engaged to perform.

**STATUTORY RESTRICTIONS ON TERMINATION OF EMPLOYMENT CONTRACT:** An employer may not dismiss an employee under the following circumstances:

*Maternity Protection:* An employer may not dismiss a female employee who has been confirmed to be pregnant and has served a notice of pregnancy.

*Paid Sick Leave:* An employer may not dismiss an employee whilst the employee is on no paid sick leave.

*Giving evidence or information to the authorities:* An employer may not dismiss an employee by reason of his giving evidence or information in any proceedings or inquiry in connection with the enforcement of the Employment Ordinance, work accidents or breach of work safety legislation.

*Trade Union Activities:* An employer may not dismiss an employee for trade union membership and activities.

*Injury at Work:* An employer may not dismiss an injured employee before having entered into an agreement with the employee for the employee's compensation or before the issue of a certificate of assessment.

**TERMINATION PAYMENTS:** The items and amount of payments payable to an employee on termination of employment or expiry of the contract depend on a number of factors such as



the length of service, the terms of the employment contract and the reason for termination of the contract. Termination payments usually include :

- outstanding wages;
- wages in lieu of notice, if any;
- payment in lieu of any untaken annual leave, and any pro rata annual leave pay for the current leave year;
- any outstanding sum of end of year payment (where applicable);
- where appropriate, long service payment or severance payment; and
- other payments under the employment contract, such as, gratuity, provident fund, etc.

### Employment Protection

The Part on Employment Protection of the Employment Ordinance aims to discourage employers from dismissing, or varying the contractual employment terms of, their employees in order to evade their liabilities under the Employment Ordinance.

**ELIGIBILITY AND REMEDIES FOR EMPLOYMENT PROTECTION:** An employee may claim for remedies against an employer in the following situations:

| SITUATION  | CONDITIONS  | REMEDIES  |
|--|---|---|
| Unreasonable dismissal   | <ul style="list-style-type: none"> <li>■ The employee has been employed a continuous contract for a period of not less than 24 months; and</li> <li>■ The employee is dismissed other than for a valid reason as specified in the ordinance</li> </ul>  | <ul style="list-style-type: none"> <li>■ And order for reinstatement or reengagement; or</li> <li>■ An award of terminal payments</li> </ul>  |
| Unreasonable variation of the terms of the employment contract | <ul style="list-style-type: none"> <li>■ The employee has been employed under a continuous contract;</li> <li>■ The terms of the employment contract are varied without the employee's consent;</li> <li>■ The employment contract does not contain an express term which allows such a variation; and</li> <li>■ The terms of the employment contract are varied other than for a valid reason as specified in the Ordinance.</li> </ul> | <ul style="list-style-type: none"> <li>■ An order for reinstatement or reengagement; or</li> <li>■ An award of terminal payments</li> </ul>   |
| Unreasonable and unlawful dismissal                            | <ul style="list-style-type: none"> <li>■ The employee is dismissed other than for a valid reason as specified in the Ordinance; and</li> <li>■ The dismissal is in contravention of the law</li> </ul>  | <ul style="list-style-type: none"> <li>■ An order for reinstatement or reengagement; or</li> <li>■ An award of terminal payments; and/or</li> <li>■ An award of compensation not exceeding \$150,000</li> </ul> |

**VALID REASONS FOR DISMISSAL OR VARIATION OF THE TERMS OF THE EMPLOYMENT CONTRACT:** The five valid reasons for dismissal or variation of the terms of the employment contract are:

- the conduct of the employee
- the capability or qualifications of the employee for performing his work
- redundancy or other genuine operational requirements of the business
- statutory requirements (i.e. it would be contrary to the law to allow an employee to continue to work in his original position or to continue with the original terms of his employment contract)
- other substantial reasons

**REMEDIES FOR EMPLOYMENT PROTECTION:** Remedies for Employment Protection, which are awarded by the Labour Tribunal, include an order of reinstatement or re-engagement, an award of terminal payments and an award of compensation.

### Severance Payment and Long Service Payment

**ELIGIBILITY FOR SEVERANCE PAYMENT AND LONG SERVICE PAYMENT:** An employee is eligible for severance payment or long service payment subject to the following conditions

| ENTITLEMENT                     | SEVERANCE PAYMENT   | LONG SERVICE PAYMENT  |
|---------------------------------|---|---|
| Qualifying period of employment | Not less than 24 months under a continuous contract                                       | Not less than 5 years under a continuous contract   |
| Conditions/Requirements         | The employee is dismissed by reason of redundancy*  | The employee is dismissed but: <ul style="list-style-type: none"> <li>■ he is not summarily dismissed due to his serious misconduct;</li> <li>■ his dismissal is not by reason of redundancy</li> </ul> |
|                                 | Employment contract of a fixed term expires without being renewed by reason of redundancy | Employment contract of a fixed term expires without being renewed*  |
|                                 | The employee is laid off  | <ul style="list-style-type: none"> <li>■ The employee dies</li> <li>■ The employee resigns on ground of ill health</li> <li>■ The employee, aged 65 or above, resigns on ground of old age</li> </ul>   |

\* An employee will not be simultaneously entitled to both long service payment and severance payment.

## Meaning of Redundancy

An employee is taken to be dismissed by reason of redundancy if the dismissal is due to the fact that: (i) the employer closes his business; (ii) the employer has ceased the business in the place where the employee was employed; or (iii) the requirement of the business for employees to carry out work of a particular kind ceases or diminishes.

## Meaning of Lay-off

If an employee is employed on such terms and conditions that his remuneration depends on his being provided by the employer with work of the kind he is employed to do, he will be taken to be laid off if the total number of days on which no work is provided or no wages are paid exceeds: (i) half of the total number of normal working days in any four consecutive weeks; or (ii) one-third of the total number of normal working days in any 26 consecutive weeks.

AMOUNT OF SEVERANCE PAYMENT/ LONG SERVICE PAYMENT: The following formula applies to the calculation of both severance payment and long service payment:

*Monthly-paid employee* = (last month wages x 2/3) x reckonable years of service

*Daily-rated/piece-rate employee* = Any 18 days' wages chosen by the employee out of his last 30 normal working days x reckonable years of service

## Protection Against Anti-Union Discrimination

RIGHT OF AN EMPLOYEE IN PARTICIPATING IN TRADE UNIONS: Every employee shall have the rights to be a member or an officer of a trade union and to take part in the activities of the trade union. An employer shall not prevent or deter an employee from exercising any of the above rights and shall not dismiss, penalise or discriminate against an employee for exercising such rights.

## The Employees' Compensation Ordinance

APPLICATION OF THE EMPLOYEES' COMPENSATION ORDINANCE: The Employees' Compensation Ordinance applies to all full-time or part-time employees who are employed under contracts of service or apprenticeship, including domestic helpers, agricultural employees, crew members of a Hong Kong ship, and any person employed in any capacity on board of a Hong Kong ship.

The Employees' Compensation Ordinance also applies to employees employed in Hong Kong by local employers injured while working outside Hong Kong. Even if the employer is a person carrying on business outside Hong Kong, or the employee is a crew member of a foreign ship,

the Employees' Compensation Ordinance still applies if the employer submits to the jurisdiction of the Courts of Hong Kong. The Employees' Compensation Ordinance does not however apply to casual employees, outworkers or members of the employer's family who live with him.

#### STATUTORY LIABILITY OF THE EMPLOYER:

*Injury by Accident.* If an employee sustains an injury or dies as a result of an accident arising out of and in the course of his employment, his employer is in general liable to pay compensation under the Employees' Compensation Ordinance.

*Occupational Disease.* An employee suffering incapacity arising from an occupational disease as defined in the Employees' Compensation Ordinance is entitled to receive the same compensation as that payable to an employee injured in an accident arising out of and in the course of employment, subject to certain qualifying requirements.

Where an employee suffers from a disease outside the scope of the Employees' Compensation Ordinance, he/she may still claim compensation thereunder if the disease is certified to be a personal injury by accident arising out of and in the course of employment.

**COMPULSORY INSURANCE:** The Employees' Compensation Ordinance obliges an employer to obtain a policy of insurance to cover its liabilities both under the Employees' Compensation Ordinance and at common law for injuries at work in respect of all its employees.

| NO. OF EMPLOYEES  | AMOUNT OF INSURANCE COVER PER EVENT |
|-------------------|-------------------------------------|
| Not more than 200 | Not less than \$100 million         |
| More than 200     | Not less than \$200 million         |

#### CLAIMS FOR DAMAGES BY ACTION AT COMMON LAW:

| AGAINST A THIRD PARTY   | AGAINST AN EMPLOYER   |
|---|---|
| <p><i>By an employee:</i> When an employee is injured in circumstances which created a legal liability in some person other than the employer, he may take proceedings to recover damages from the third party as well as claiming compensation against the employer.</p> | <p>The Ordinance does not limit the civil liability of an employer. Thus, when an injury to an employee is caused by the negligence or other wrongful act of an employer, the employee may recover compensation and also sue for damages, but the damages awarded will be reduced by the value of the compensation paid or payable under the Ordinance.</p> |
| <p><i>By an employer:</i> Similarly, an employer who is liable to pay compensation may take action against a third party to recover the compensation, indemnity or any sum payable to the employee contractually.</p>   |   |

## **Mandatory Provident Fund Schemes Ordinance**

To provide retirement protection to the entire workforce in Hong Kong, a mandatory provident fund ("MPF") system was introduced under the Mandatory Provident Fund ("MPF") Schemes Ordinance in 2000. It requires both employees (with the exception of certain exempt persons) and employers to make regular contributions into a registered MPF scheme. Every employer is obliged to contribute an amount equal to at least 5% of an employee's salary (subject to the maximum level of income, currently set at \$25,000 per month) to such MPF scheme. Every employee is also required to contribute at least 5% of his/her salary to the scheme, also subject to the same maximum level of income.

A number of employers had been operating voluntary retirement schemes regulated under the Occupational Retirement Schemes Ordinance (Cap 426) ("ORSO") before the introduction of the MPF scheme. Many such voluntary ORSO schemes obtained MPF exemption and continue to operate. Members of an MPF-exempted ORSO scheme, as well as new employees eligible to join an MPF-exempted ORSO scheme after the commencement of the MPF system, have a one-off option to choose between the ORSO scheme and an MPF scheme.

## **Anti-discrimination legislation**

There are certain anti-discrimination laws in force in Hong Kong: the Sex Discrimination Ordinance (Cap. 480), Disability Discrimination Ordinance (Cap. 487), the Family Status Discrimination Ordinance (Cap. 527) and the Race Discrimination Ordinance (Cap. 282) to prohibit discrimination on the basis of sex, pregnancy, marital status, disability, family status and race. Further, there are also provisions in the Employment Ordinance guarding against discrimination on the ground of trade union membership.

## **→ Tax Law**

The Hong Kong tax system is relatively simple in comparison with some of the more complicated systems in other countries. In Hong Kong, there are three separate direct taxes which are levied under the Inland Revenue Ordinance (Cap. 112) (the "IRO"). The three taxes are: profits tax, salaries tax and property tax. The ambit of the IRO is limited territorially and it is only income with a Hong Kong source which, by and large, is subject to tax.

### **Profits tax**

THE SCOPE OF THE CHARGE: Persons, including corporations, partnerships, trustees and bodies of persons carrying on any trade, profession or business in Hong Kong are chargeable to profits tax on the assessable profits arising in or derived from Hong Kong from such trade, profession or

business. No distinction is made between residents and non-residents. A resident may therefore derive profits from abroad without being subject to tax; conversely, a non-resident may be chargeable to tax on profits arising in or derived from Hong Kong. Whether a business is carried on in Hong Kong and whether profits are derived from Hong Kong are largely questions of fact. However some guidance on the principles applied can be found in cases which have been considered by the courts in Hong Kong and in other common law jurisdictions.

**THE BASIC OF ASSESSMENT:** Tax is charged on the assessable profits for a year of assessment. The assessable profits for a business which makes up annual accounts are calculated on the profits of the year of account ending in the year of assessment. In the year of assessment itself, a provisional tax is required to be paid based on the profits assessed for the preceding year. The provisional payment is applied in the first instance against profits tax payable on assessable profits for that year of assessment when agreed in the following year. Any excess is then applied against the provisional profits tax payable for that succeeding year.

**TAX RATES:** The tax rates for profits tax applicable to corporations are set out as follows:

| YEAR OF ASSESSMENT | TAX RATE |
|--------------------|----------|
| 2008/09 onwards    | 16.5%    |
| 2003/04 to 2007/08 | 17.5%    |
| 667 1/3            | 16%      |

The tax rates for profits tax applicable to unincorporated business are set out as follows:

| YEAR OF ASSESSMENT | TAX RATE |
|--------------------|----------|
| 2008/09 onwards    | 15%      |
| 2004/05 to 2007/08 | 16%      |
| 500 3/4            | 15.5%    |
| 667 1/3            | 15%      |

**EXEMPTIONS AND DEDUCTIONS:** Dividends from a corporation which is subject to Hong Kong profits tax, as well as amounts already included in the assessable profits of other taxpayers chargeable to profits tax, are not included in the assessable profits of the recipient. In general, all expenses, to the extent to which they have been incurred in the production of chargeable profits, are deductible. They include (but are not limited to):

- Rent paid by any tenant of buildings or land occupied for the purpose of producing the assessable profits;
- Bad and doubtful debts (subject to certain rules);
- Repairs of premises, plant, machinery or articles etc used in producing the profits;

- Expenditure for registration of a trademark, design or patent and expenditure on the purchase of patent rights or rights to any know-how for use in Hong Kong in the production of assessable profits;
- Expenditure on research and development (subject to certain rules); and
- Donations of an aggregate of not less than HK\$100 made to approved charities with the restriction that such donation should not exceed 35% from year of assessment 2008/09 and onwards of the adjusted assessable profits.

**TAX INCENTIVES:** Tax incentives are available in certain specific areas and these incentives include (but are not limited to):

- Immediate writing off is allowed for capital expenditure on plant and machinery specifically and directly related to manufacturing processes, and on computer hardware and software.
- Capital expenditure on refurbishment of business premises is allowed to be written off over five years of assessment.
- Exemption from payment of tax on interest derived from any deposit placed in Hong Kong with an authorised institution (not applicable to interest received by or accrued to a financial institution).
- Accelerated deduction for capital expenditure on specified environmental protection facilities from year of assessment 2008/09 and onwards. For machinery or plant, 100% deduction will be allowed for the capital expenditure incurred. For installations forming part of a building or structure, 20% deduction will be allowed for each year in five consecutive years.
- 100% deduction for capital expenditure on specified environmental-friendly vehicles from year of assessment 2010/11 and onwards.

**LOSS RELIEF:** Losses incurred in an assessment year can be carried forward and set off against assessable profits in subsequent assessment years.

**BOOKS AND RECORDS:** All persons who carry on business in Hong Kong must keep sufficient records, in English or Chinese, of their income and expenditure to enable their assessable profits to be readily ascertained. There are statutory requirements to record certain specified details of every business transaction. Business records must be retained for at least 7 years after the date of the transaction to which they relate. Any person who fails to keep sufficient records can be subject to a fine of HK\$100,000.

## **Salaries Tax**

**THE SCOPE OF THE CHARGE:** Salaries tax is charged on all income arising in or derived from Hong Kong from an office, employment or pension. In determining whether income “arises in or is derived from Hong Kong”, it is necessary to establish where the employment, i.e. the source of income, is located. “Income arising in or derived from Hong Kong from any employment” includes all income derived from services rendered in Hong Kong, without in any way limiting the meaning of the expression.

**THE BASIS OF ASSESSMENT:** Liability to salaries tax is based on the chargeable income of the year of assessment, but the total amount of income for the year cannot be determined until the

year is past. Accordingly, the Inland Revenue Department will first demand for payment of provisional salaries tax during the year of assessment and then make adjustments in the following year. Any provisional tax paid for a year of assessment is applied firstly against the salaries tax payable on the income for that year and if there is excess, apply the excess against the following year's provisional tax liability.

**INCOME OF HUSBAND AND WIFE:** A married person is responsible for all aspects of his or her own salaries tax affairs including lodgement of returns and payment of tax assessed. However, if the total tax liability of a married couple under two separate assessments is greater than it would have otherwise been when their incomes are aggregated, they may elect to be jointly assessed.

**DEDUCTIONS ALLOWED:** The following deductions are allowable:

■ Expenses wholly, exclusively and necessarily incurred in the production of assessable income, not being expenses of a private, domestic nature or capital expenditure.

■ Donations paid to approved charities if the amount is not less than HK\$100 and with the limitation that such allowance should not, from year of assessment 2008/09 and onwards, exceed 35% (25% for years of assessment 2005/06 to 2007/08) of the income after allowable expenses and depreciation allowances.

■ Self-education expenses paid on fees (including tuition and examination fees) in relation to a 'prescribed course of education', or on fees in respect of an examination set by the specified education providers or trade, professional or business associations. The course and examination must be for gaining or maintaining a qualification for use in any employment.

A 'prescribed course of education' is a course undertaken at an education provider, specified education providers, such as a university, college, school, technical institution, training centre, or a training or development course provided by a trade, professional or business association or one accredited or recognised by specified professional bodies or institutions.

The amount deducted should exclude any amount that has been or will be reimbursed by the employer or any other persons. The maximum deduction is as follows:

| YEAR OF ASSESSMENT  | MAXIMUM DEDUCTION (IN HK\$) |
|---------------------|-----------------------------|
| 286 4/7             | \$40000                     |
| 2007/08 and onwards | \$60000                     |

■ Elderly residential care expenses paid by the person or his/her spouse to a residential care home in respect of the person's or his/her spouse's parent or grandparent. To be eligible for the deduction, the parent/grandparent must be 60 years old or above at any time in the year of



assessment, unless he / she is entitled to claim an allowance under the Government's Disability Allowance Scheme; and the residential care home must be situated in Hong Kong and be licensed or exempted from licensing under the Residential Care Homes (Elderly Persons) Ordinance (Cap.459) or Residential Care Homes (Persons with Disabilities) Ordinance (Cap.613), or be a nursing home registered under the Hospital, Nursing Homes and Maternity Homes Registration Ordinance (Cap.165).

Should the deduction be allowed to a person, he or any other person is not entitled to claim dependent parent and grandparent allowance and additional dependent parent and grandparent allowance for the same parent/grandparent for the same year of assessment. The maximum deduction for each parent or grandparent is as follows:

| YEAR OF ASSESSMENT  | MAXIMUM DEDUCTION (IN HK\$) |
|---------------------|-----------------------------|
| 2006/07 to 2010/11  | \$60000                     |
| 167 7/12            | \$72000                     |
| 2012/13 and onwards | \$76000                     |

■ A taxpayer can, for any 15 years of assessment (not necessarily consecutive), claim deductions of HK\$100,000 (maximum) a year for "home loan interest" paid on a home loan for the acquisition of a property unit which must be situated in Hong Kong and must be used as his/her place of residence during the year of assessment.

■ For mandatory contributions paid to a mandatory provident fund ("MPF") scheme by a taxpayer as an employee, the maximum deduction for each year of assessment is:

| YEAR OF ASSESSMENT  | MAXIMUM DEDUCTION (IN HK\$) |
|---------------------|-----------------------------|
| 2006/07 to 2011/12  | \$12,000                    |
| 2012/13             | \$14,500                    |
| 2013/14 and onwards | \$15,000                    |

■ Contributions paid to a recognised occupational retirement ("ROR") scheme are subject to the following restrictions:

- the amount deductible is the lesser of the actual amount contributed to the ROR scheme or the amount of mandatory contribution that person would have been required to pay had that scheme been a MPF scheme; and
- the maximum deduction for each year of assessment is:

| YEAR OF ASSESSMENT  | MAXIMUM DEDUCTION (IN HK\$) |
|---------------------|-----------------------------|
| 2006/07 to 2011/12  | \$12,000                    |
| 2012/13             | \$14,500                    |
| 2013/14 and onwards | \$15,000                    |

### Property tax

**THE SCOPE OF THE CHARGE:** Property tax is charged on the owners of land and/or buildings in Hong Kong and is computed at the standard rate on the net assessable value of the property. The standard rate is 16% for years of assessment 2005/06 to 2007/08 and 15% from year of assessment 2008/09 and onwards.

**THE BASIS OF ASSESSMENT:** The assessable value is computed by reference to the actual consideration payable to the owner in respect of the right of use of the property. Examples of consideration to be included in the assessable value are gross rent received or receivable, payment for the right of use of premises under licence, lump sum premium, service charges or management fees paid to the owner, and the owner's expenditure (e.g. repairs) borne by the tenant. The net assessable value is the assessable value (after deduction of rates agreed to be paid and paid by the owner and irrecoverable rent, but not other payments e.g. government rent and management fee) less a 20% statutory allowance for repairs and outgoings. However, any sums previously deducted as irrecoverable and then recovered should be treated as consideration in the year of recovery.

### Completion of tax return

Tax Return-Individuals is to be used by an individual to report all his employment income, profits from sole proprietorship businesses and rental income from solely owned properties. Owners of jointly-owned properties who receive rental income are required to file property tax returns. For partnerships and corporations, profits tax returns should be filed.

### Double taxation

A taxpayer could be subject to both Hong Kong tax and overseas tax. The IRO provides that Hong Kong may make arrangement with other territories to afford relief from double taxation when the other jurisdiction imposes a tax similar in nature to a Hong Kong tax.

To prevent the double taxation of income between Hong Kong and the PRC, a comprehensive double taxation arrangement was signed between the two parties in August 2006. Such arrangement covers profits tax, salaries tax and property tax, whether or not the tax is charged under personal assessment, in Hong Kong; and individual income tax and enterprise income tax in the PRC.

In addition, comprehensive double agreements have also been concluded by Hong Kong with various other countries. A complete list of the agreements with the respective dates of signature and the coming into effect are set out as follows.

| COUNTRY / TERRITORY | DATE OF SIGNATURE OF AGREEMENT | EFFECTIVE FROM<br>(YEAR OF ASSESSMENT) |
|---------------------|--------------------------------|--|
| Austria             | 25.05.2010                     | 1                                      |
| Belgium             | 10.12.2003                     | 1                                      |
| Brunei              | 20.03.2010                     | 1                                      |
| Czech               | 06.06.2011                     | 1                                      |
| France              | 21.10.2010                     | 1                                      |
| Hungary             | 12.05.2010                     | 1                                      |
| Indonesia           | 23.03.2010                     | 1                                      |
| Ireland             | 22.06.2010                     | 1                                      |
| Japan               | 09.11.2010                     | 1                                      |
| Jersey              | 22.02.2012                     | Pending                                |
| Kuwait              | 13.05.2010                     | Pending                                |
| Liechtenstein       | 12.08.2010                     | 1                                      |
| Luxembourg          | 02.11.2007                     | 1                                      |
| PRC                 | 21.08.2006                     | 1                                      |
| Malaysia            | 25.04.2012                     | Pending                                |
| Malta               | 08.11.2011                     | 1                                      |
| Mexico              | 18.06.2012                     | Pending                                |
| Netherlands         | 22.03.2010                     | 1                                      |
| New Zealand         | 01.12.2010                     | 1                                      |
| Portugal            | 22.03.2011                     | 1                                      |
| Spain               | 01.04.2011                     | 1                                      |
| Switzerland         | 04.10.2011                     | Pending                                |
| Thailand            | 07.09.2005                     | 1                                      |
| United Kingdom      | 21.06.2010                     | 1                                      |
| Vietnam             | 16.12.2008                     | 1                                      |

### Stamp duty

Stamp duty is chargeable on the documents set out in the First Schedule to the Stamp Duty Ordinance (Cap. 117) which imposes fixed duty on some documents and an ad valorem duty on others. Fixed duties vary from HK\$3 to HK\$100 whereas ad valorem duties range from 0.1% to 4.25%.

In the case of conveyances of immovable property, stamp duty is calculated at rates which vary with the amount / value of the consideration or value of the property as follows.

| AMOUNT OR VALUE OF THE CONSIDERATION OR<br>VALUE OF THE PROPERTY (IN HK\$) |                        | RATE (WITH EFFECT FROM 1 APRIL 2010)            |
|--|------------------------|---|
| <i>Exceeds</i>   | <i>Does not exceed</i> |   |
|  | \$2000000              | HK\$100   |
| \$2000000  | \$2351760              | HK\$100 + 10% of excess over HK\$2,000,000      |
| \$2351760  | \$3000000              | 1.5%  |
| \$3000000  | \$3290320              | HK\$45,000 + 10% of excess over HK\$3,000,000   |
| \$3290320  | \$4000000              | 2.25%   |
| \$4000000  | \$4428570              | HK\$90,000 + 10% of excess over HK\$4,000,000   |
| \$4428570  | \$6000000              | 3.00%   |
| \$6000000  | \$6720000              | HK\$180,000 + 10% of excess over HK\$6,000,000  |
| \$6720000  | \$20000000             | 3.75%   |
| \$20000000   | \$21739120             | HK\$750,000 + 10% of excess over HK\$20,000,000 |
| \$21739120   |                        | 4.25%   |

For residential property acquired on or after 20 November 2010 and disposed within 24 months, Special Stamp Duty ("SSD") will be imposed in addition to the ad valorem duty. The amount of SSD is calculated by reference to the stated consideration or the market value of the property (whichever is higher) at the following regressive rates for different holding periods by the transferor before the disposal:

| HOLDING PERIOD                                | RATE |
|---|------|
| 6 months or less                              | 15%  |
| More than 6 months but for 12 months or less  | 10%  |
| More than 12 months but for 24 months or less | 5%   |

Leases granted in consideration of premium only attract the same duties as for conveyances of land. For leases granted in consideration of both premium and rent, the premium attracts an ad valorem duty of 4.25% while the rate of duty on rents varies with the period of the lease (from 0.25% to 1% of the annual rent).

Transactions in Hong Kong stock require the preparation of contract notes on which buyers and sellers have each to pay ad valorem duty at the rate of 0.1% of the consideration.

In all cases, the Collector of Stamp Revenue is empowered to charge duty based on the market value of the property conveyed or shares transferred if he is of the opinion that the consideration is inadequate.

### **Evasion of tax**

All tax returns contain a declaration to the effect that the information returned therein is true, correct and complete. Understatement / omission of profits or income or submission of false information constitutes an offence.

Submission of an incorrect tax return without reasonable excuse is an offence carrying a fine of HK\$10,000 and a further fine of treble the amount of tax which has been undercharged. The imposition of penalty may, however, be dealt with administratively by the Commissioner of Inland Revenue.

Submission of an incorrect tax return wilfully with intent to evade tax is a serious offence. On conviction, the maximum penalty is a fine of HK\$50,000 plus a further fine of treble the amount of tax undercharged and to imprisonment for 3 years.

### **Advance rulings**

Subject to payments and certain regulations, a person may apply to the Commissioner of Inland Revenue for a ruling on how any provision of the IRO applies to him or the arrangement specified in the application.

## **→ Real Estate Law**

### **Types of Ownership**

**LEASEHOLD LAND:** Since the return of sovereignty on 1 July 1997, virtually all land in Hong Kong is owned by the government of Hong Kong, which is part of the People's Republic of China. Therefore, all land in Hong Kong is leasehold land except for the land on which St. John's Cathedral is situated.

Previously, the Hong Kong government granted land for private leaseholding by way of a government lease, which granted the leasehold land to the purchaser for a certain number of years.

Since government leases are no longer issued, land is granted by way of conditions of sale, exchange, or grant (“Government Grant”). A Government Grant is a contract whereby once the conditions have been complied with, a government lease is deemed to be issued pursuant to section 14 of the Conveyancing and Property Ordinance (Cap. 219) (“CPO”). This is what is now known as a “Government Lease”.

Subject to the terms of the Government Lease, a leaseholder of land is at liberty to deal with his or her leasehold interest in the lot granted by the government, including:

- the selling or disposal of his or her interest in the lot;
- dividing and sectioning the lot into smaller segments and selling off parts of them; or
- sub-dividing the lot by constructing and building structures over the lot and assigning all or part of the sub-divided units or flats (in case of multi-storey building) to different purchasers.

**JOINT OWNERSHIP OF LEASEHOLD LAND:** Hong Kong allows co-ownership of a leasehold interest in real property in the form of either:

- joint tenants; or
- tenants-in-common.

Pursuant to the CPO, where the same estate or interest in land vests in 2 or more persons under an instrument or a will, it is be presumed that (unless a contrary intention is expressed in that instrument or will) the tenancy vests in those persons as tenants-in-common rather than as joint tenants.

Tenants-in-common jointly own the undivided shares of a property as a whole. However, each of the tenants-in-common may own the property in a ratio determined by them, i.e., either in equal shares or in different proportions.

Real property may also be held as joint tenants and each joint tenant will have an identical interest in terms of the extent, nature and duration with respect to the whole and every part of the real property. Joint tenancy gives rise to a right of survivorship in accordance with which the interest of a deceased joint tenant will automatically pass to and vest in the survivor(s).

Co-ownership by way of tenants-in-common differs materially from joint tenancy in that there is no automatic right of survivorship. A tenant-in-common’s interest in property will be part of his or her estate and can pass either under a will or upon his or her intestacy. Under the CPO, a company is capable of acquiring and holding real property as a co-owner in the same manner as if it were a natural person pursuant to the CPO.

**OWNERSHIP OF LAND AND/OR BUILDINGS:** The ownership of a building situated on a certain lot of land is not implied in the “ownership” of that land. However, a deed of mutual covenant between the co-owners of the building governing the use of the building and land usually provides that the owner of the undivided share of the land will have the exclusive right to use

and occupy the unit relating to that undivided share. Also, the ownership of a building will not necessarily imply the ownership of the land on which it is situated, and it is possible to have different owners of the land and the building erected on it.

## Land registration

Hong Kong has a voluntary land registration system that is governed by the Land Registration Ordinance [Cap. 128] ("LRO").

The land registration system in Hong Kong functions to:

- protect the priority of registrable and registered interest;
- facilitate title tracing and checking; and
- giving notice of the registrable and registered interest to subsequent purchasers and mortgagees.

For the purpose of land registration, interests in land may be classified either as registrable (i.e., capable of being reduced into writing) or unregistrable (i.e., incapable of being reduced into writing).

Registrable interests such as deeds, conveyances, instruments in writing and judgments affecting real property in Hong Kong may be registered with the Land Registry and such registration:

- renders any registrable but unregistered interest unenforceable against any subsequent bona fide purchasers or mortgagees for valuable consideration; and
- precludes a registering party from being affected by any actual notice of a prior registrable but unregistered interest.

Neither the CPO (in respect of the writing requirement) nor the LRO (in respect of the registration requirement) apply to unregistrable interests in land, such as any unwritten equities creating interests in land arising out of constructive trusts (e.g. interest of a wife in the real property arising out of promise or the husband and wife relationship) or resulting trust (e.g. interest of Party X in the real property arising out of contributions of purchase money or mortgage repayment by Party X in relation to the real property purchased by Party Y).

The common law doctrine of notice determines the priority of unregistrable interest, under which priority may be given to those unwritten equity interests over a subsequent registered interest if the subsequent purchasers or mortgagees have notice of such equity interest when they acquire the interest in land. Moreover, the LRO expressly precludes the registration requirement for any short-term tenancy not exceeding 3 years and without any option to renew for another term.

In essence, the land registration system in Hong Kong offers protection and priority to a bona fide purchaser for valuable consideration against any registrable but unregistered interest in land, but a purchaser should always ascertain whether there is any unregistrable interest or short term tenancy affecting the property which may take priority over his or her interest in the property.

### **Real estate transaction procedures**

In Hong Kong, real estate transactions are governed by the CPD, as supplemented by common law. Property transactions in Hong Kong may be divided and classified into three main stages:

- the provisional agreement stage;
- the formal sale and purchase agreement stage; and
- the assignment and completion stage.

**PROVISIONAL AGREEMENT STAGE:** The sale and purchase of properties in Hong Kong is generally commenced through meetings with, and the engagement of, real estate agencies, who will conduct preliminary searches through the Land Registry for the property particulars and prepare a binding provisional agreement which contains simple and standard terms for the vendor and the purchaser to sign when they have agreed to the sale and purchase of a particular property.

In practice, common terms of a provisional agreement include:

- an initial deposit of about five per cent of the purchase price is paid by the purchaser to the vendor on the signing of the provisional agreement; and
- liquidated damages in an amount equivalent to the initial deposit to be payable by the party in default to the innocent party in the event of any breach or default of the provisional agreement; or
- in provisional agreements without a liquidated damages clause a specific performance clause allowing the innocent party to compel the defaulting party to complete the sale in addition to any claim for damages.

A commission of one per cent of the purchase price will normally be charged by the real estate agencies and paid by each party. The defaulting party will normally have to bear the costs of the estate agent's commission on behalf of the innocent party.

**FORMAL SALE AND PURCHASE AGREEMENT:** Both the vendor and the purchaser engage their respective lawyers to proceed with the property transaction after the signing of the provisional agreement. The vendor's solicitors will prepare a formal sale and purchase agreement with detailed terms and conditions reflecting the terms in the provisional agreement for the purchaser's solicitors' review and comments.

The vendor and the purchaser will usually, but not necessarily, enter into the formal sale and purchase agreement within 14 days after signing the provisional agreement. A further deposit will be paid by the purchaser, making up a cumulative total of ten per cent of the purchase price



(taking into account the initial deposit). In some cases where the parties agree, the vendor's solicitor may act as stakeholder whereby the solicitor holds the ten per cent deposit for the vendor until the conditions of the stakeholdings are fulfilled, usually, upon proof that the balance of the purchase price is sufficient to discharge the mortgage (if any).

In relation to the purchase of a residential property, for the protection of the purchaser, the purchaser's solicitors will arrange stamping of the provisional agreement and/or formal sale and purchase agreement with the Stamping Office at the Inland Revenue Department and registration of the same with the Land Registry within 30 days after signing.

In relation to the purchase of a non-residential property, stamp duty is not payable on the formal sale and purchase agreement. However, the purchaser's solicitor will still arrange registration of the formal sale and purchase agreement directly with the Land Registry within 30 days after signing.

**ASSIGNMENT AND COMPLETION:** After the formal sale and purchase agreement stage, the vendor's solicitors will provide the title deeds and documents to the purchaser's solicitors, who will then carry out due diligence on the title. It is common practice in Hong Kong that any questions and requisitions concerning the vendor's title should be raised within seven working days after the date of receipt of the title deeds, save and except that requisitions going to the root of the title can be raised at any time before completion.

The vendor's solicitors must answer the title requisitions honestly and allow sufficient time for the purchaser to consider the answers. Once the purchaser's solicitors consider that the requisitions have been properly answered and the vendor is able to give good title to the subject property, they will prepare the assignment and conduct pre-completion land searches to ascertain the status of the subject property.

On completion, the purchaser will obtain vacant possession of the subject property (if the property is being sold with vacant possession) and the vendor and the purchaser will sign and execute the assignment to effect the transfer of title from the vendor to the purchaser.

Within 30 days after signing of the assignment, for the protection of the purchaser, the purchaser's solicitors will arrange stamping of the assignment with the Stamping Office at the Inland Revenue Department and registration of the assignment with the Land Registry.

## **Tax**

**TAX ON TRANSACTIONS – STAMP DUTY:** Real property transactions in Hong Kong are subject to stamp duty pursuant to the Stamp Duty Ordinance [Cap. 117]. Stamp duty will be imposed on both the agreement and assignment of real property (for non-residential properties, stamp duty is chargeable only on the assignment for the transfer).

For properties not exceeding HK\$2,000,000, the stamp duty payable is only HK\$100; for property consideration exceeding HK\$2,000,000, the stamp duty payable is on a sliding scale, up to 4.25 per cent of the amount or value of the consideration price.

**TAX ON TRANSACTIONS – PROFITS TAX:** The Inland Revenue Department will charge profits tax on any persons, including corporations, partnerships and bodies of persons who derive profits through carrying on a trade, profession or business in Hong Kong.

It is a question of fact as to whether a business is being carried on as a result of any sale and purchase of real property in Hong Kong, in which case some of the relevant factors that will be taken into account are as follows:

- the time or length of ownership of the property;
- the use of the property;
- the financial situation of the purchaser when the property was purchased;
- whether a mortgage was taken out;
- whether the property was leased; and
- all other circumstantial factors to ascertain whether the intention of the purchase of the property was for long-term investment or for business.

In the event that any sale and purchase of real property by any persons, including corporations, is deemed or regarded by the Inland Revenue Department as carrying on a real estate business in Hong Kong, the profits tax rate presently applicable is 16.5 per cent for corporations and 15 per cent for unincorporated businesses including partnerships and sole proprietors.

**TAX ON HOLDING REAL ESTATE:** Government rent and rates are chargeable on real estate property at an amount of three per cent and five per cent, respectively, based on the rateable value which is the estimated annual rental value of the subject property at a designated valuation reference date, assuming that the property was then vacant and for lease.

### **Termination of existing tenancy on a lease**

A lease creates an interest in land and in the event that there is an existing tenancy in respect of the real property, a purchaser will have to purchase the real property subject to the lease interest. It is advisable for a purchaser to ascertain if the vendor is able to deliver the subject property with vacant possession free from any lease and tenancy.

To terminate the existing tenancy, the purchaser will have to seek recourse to the termination provisions of the lease (such as early termination) and subject to the terms of the lease, the purchaser may be able to effect early termination of the tenancy.

## Restrictions on development

**CHANGING THE USE OF LAND:** Government Leases usually contain restrictions as to land use. In the event that a leaseholder wishes to use the land for a specific purpose that does not comply with the lease conditions, an application for a lease modification should be made to the Lands Department in order to vary the conditions under the Government Lease. A lease modification is a variation of the conditions of the Government Lease in respect of the property, including the permitting of a change of use.

The Lands Department may also refer the application to other relevant departments for approval, including the Planning Department, Building Department and Fire Services Department. Each application will be considered on a case-by-case basis together with the relevant circumstances.

If the Lands Department approves of the application for the lease modification, then the modification will be reflected by way of a deed of variation or letter of modification.

In addition, the leaseholder will be required to pay a premium reflecting the enhanced value of the property. It may also be the case that additional conditions relating to the new use of the property are imposed.

Approval for an application for a lease modification normally takes at least six months.

**CHANGING THE USE OF AN EXISTING BUILDING:** In relation to individual flats or units in a multi-storey building, usage is governed by the deed of mutual covenant between the co-owners of the building governing the use of the building and the occupation permit and shall be the same as that stipulated in the conditions of sale, grant or exchange. Any changes to the deed of mutual covenant are subject to the approval of all the owners of a particular building.

Given the fact that any variations or modifications in building usage must be:

- approved by the Lands Department;
  - subject to the payment of land premium; and
  - approved by all owners of the building,
- a change of usage of a building in Hong Kong is very difficult, if not impossible.

**BUILDING ON LAND:** In the event that the purchaser intends to build a building on the land, the purchaser must engage surveyors and architects to draw a building plan. That building plan must comply with the plot to volume ratio specified in the Government Lease. The plot to volume ratio specifies the floor area that can be built upon a specified piece of land. This ratio is a method used by the Hong Kong government to regulate the height of the buildings and the usable space of the buildings.

As land becomes more scarce in Hong Kong, developers are more inclined to maximize the usable space by maximizing the use of the plot of land. Therefore, apart from complying with the plot to volume ratio of the land, the Planning Department must also approve the building plan. This is to ensure the building is suitable from a city planning perspective.

The building plan must also be approved by the Lands Department, the Building Department and the Fire Services Department. Upon approval of the building plan, a certificate of approval will be issued.

A multi-story building will be notionally divided into a number of undivided shares representing the units intending to be created from the block of flats. This is usually done by the purchaser's solicitors by creating a deed of mutual covenant, which specifies the number of shares allocated to various units or areas of the building. This deed of mutual covenant must be submitted to the Lands Department and Planning Department for approval.

### **Foreign investment in real estate**

Types of foreign investment in Hong Kong's real estate market include:

- direct purchasing of real estate;
- investing in stocks of various property developers; or
- investing in real estate investment trusts ("REITs"), which are listed trusts. REITs work by investing in income-producing real estate assets and using the income derived to provide a return to its unit holders. By purchasing a unit in a REIT, it allows investors to share in the risks as well as the benefits of owning the real estate assets held by the REIT.

### **RESTRICTIONS ON ACQUISITION:**

There are no restrictions on acquisition and any individual adult person, corporation or foreign entity that has a recognized legal status and capacity may purchase property in Hong Kong.

**REPATRIATION OF FUNDS:** Subject to the anti-money laundering policies and regulations in Hong Kong, there are no restrictions on repatriation of funds from Hong Kong and a seller is free to remit monies from a property transaction in whole or in part overseas.