

1 INTRODUCTION

1.1 Please give a brief outline of the legal system in Hong Kong. Is it based on common law, civil law, or some other system?

The Hong Kong legal system is a common law system which gives great precedential weight to previous decisions of the Hong Kong courts (reference is also made to case law from other common law jurisdictions, in particular England and Wales, which would usually be regarded as “persuasive” by the Hong Kong courts).

In addition to the common law, statutes make up a large component of the Hong Kong legal system. This consists of written ordinances, which are passed by the Legislative Council of Hong Kong, and which eventually become the Laws of Hong Kong.

1.2 How are the courts organized in Hong Kong?

The Hong Kong courts are operated by the Hong Kong judiciary, independently both of the executive and the legislature. The courts of justice in Hong Kong are, from the top of the hierarchy as follows:-

- (a) The Court of Final Appeal (“**CFA**”) is the highest appellate court in Hong Kong for both civil and criminal matters and which hears appeals from the High Court.

An appeal lies to the CFA in any civil case:-

- (1) as of right, from any final judgment of the Court of Appeal, where the matter in dispute on appeal amounts to or is of the value of HK\$1,000,000 or more; or
- (2) at the discretion of the Court of Appeal or CFA, from judgments of the Court of Appeal (final or interlocutory), if, in the opinion of the Court of Appeal or CFA, as the case may be, the question involved in the appeal is of great public importance or otherwise ought to be submitted to CFA for decision.

(b) The High Court comprises of:-

- (1) The Court of Appeal which hears appeals from the Court of First Instance and the District Court in relation to civil and criminal matters and also appeals from the Lands Tribunal.
- (2) The Court of First Instance which has exclusive jurisdiction to hear civil claims in excess of HK\$1 million and deals with the most serious criminal offences.

(c) The District Court which has limited jurisdiction in both civil and criminal matters:-

- (1) In relation to civil matters, it has jurisdiction in respect of claims exceeding HK\$50,000 but not exceeding HK\$1 million.
- (2) It can hear serious criminal matters except for murder, manslaughter and rape (with a maximum penalty of 7 years' imprisonment).

The Family Court is a part of the District Court which deals with family related matters.

(d) The Small Claims Tribunal has exclusive jurisdiction to hear civil claims not exceeding HK\$50,000.

(e) The Magistrates' Courts deal with less serious criminal offences.

Further, there are a number of courts and tribunals which adjudicate on disputes relating to specific matters (e.g. the Juvenile Court, the Coroner's Court, the Lands Tribunal and the Labour Tribunal).

1.3 How are lawyers organized in Hong Kong?

The legal profession in Hong Kong is divided into two distinct branches - barristers (also known as "counsel") and solicitors. Barristers have unlimited rights of audience in all courts and tribunals where legal representation is allowed whereas solicitors (unless accredited as "Solicitor Advocates") have limited rights of audience up to the District Court. Lawyers practising within one branch of the profession are not, at the same time, allowed to practise within the other.

Barristers can only accept instructions from solicitors and are not allowed to accept instructions directly from the general public (except where instructions are from a member of a "recognised professional body" as defined in the relevant Code of Conduct of barristers).

1.4 What type of legal fee arrangements are common in Hong Kong?

The remuneration of solicitors is usually based on an hourly rate and the time spent on each matter. Sometimes, solicitors will charge a fixed sum agreed at the time of provision of services.

Barristers are separately instructed and remunerated by a separate fee for each item of work they undertake. Similar to solicitors, they will sometimes agree to charge a fixed sum for their work.

Conditional or contingency fee arrangements are not allowed in Hong Kong for contentious business.

2. STRUCTURES FOR DOING BUSINESS

2.1 Is it necessary to set up a business organization in Hong Kong to provide services or sell goods in Hong Kong?

An individual may trade in Hong Kong (although he would have to register his business). Also, many foreign businesses access the Hong Kong market by appointing local distributors.

However, typically a limited liability company would be used for carrying on business in Hong Kong. This would either be through the establishment of a local company, or use of an off-shore company (which would have to register locally if it established a place of business), or through establishment of a branch office of a foreign corporation.

2.2 What forms of business organizations can be set up in Hong Kong?

Business organizations include:

- (a) companies (please see section 3 below)
- (b) branches of foreign companies (please see section 3 below)
- (c) representative offices of foreign companies. Representative offices are only permitted to carry on promotional and liaison work in Hong Kong and are prohibited from carrying on any business in Hong Kong or entering into any contract in Hong Kong (but must be registered under the Business Registration Ordinance).
- (d) partnerships (these are relatively uncommon, except in the context of professional services firms).

2.3 What is the process, time required and cost for setting up each?

- (a) The process and time required for setting up a company is described in section 3.2 below. The cost will vary between service providers and is likely to be divided between basic incorporation at a fairly low price and necessary post incorporation matters, but the combined cost of both aspects is likely to be in the region of US\$3,300.
- (b) If a foreign company wishes to carry on business in Hong Kong by operating through a branch office, it must register the business under the Business Registration Ordinance. It must also register as a non-Hong Kong company under the Companies Ordinance. To register under the Companies Ordinance the foreign company will need to appoint a local person authorized to accept service of proceedings and notices, and have a registered place of business, in Hong Kong, and may have to provide translations of certain of its statutory documents. The length of time and cost will depend on the efficiency with which this is done, but the Companies Registry will normally take at least 20 working days to process an application where the papers are in order.
- (c) Relative to (b) above, the procedure for registration of a representative office under the Business Registration Ordinance is simpler and less expensive. It involves filing an application form and a copy of the certificate of incorporation of the foreign company with the Business Registration Office.
- (d) Partnerships can be formed quickly (assuming negotiations are not protracted regarding the partnership agreement). The partnership agreement does not need to be registered, but the partnership itself requires registration under the Business Registration Ordinance (a straightforward matter) once it establishes a place of business in Hong Kong. There may be additional requirements depending on the industry, for example Law Society requirements on the establishment of a law firm.

2.4 Are there any fetters on the business activities that can be carried on by business organizations in Hong Kong?

In general, no, but certain types of business activities will require approvals and licences from government authorities or industry bodies before the proposed business activities can begin.

As mentioned above, a representative office is prohibited from carrying on substantive business.

2.5 What are the ongoing obligations in relation to each of the forms of business organizations?

These will vary depending on the form of business organization, with reasonably substantial filing requirements for example in the case of a company (limited companies incorporated in Hong Kong are required to have a company secretary, which takes care of filing requirements; professional services firms in Hong Kong are able to provide this service).

3. CORPORATIONS

3.1 What are the different types of companies recognized in Hong Kong?

Limited companies incorporated in Hong Kong can be public or private and can be limited by shares or by guarantee. Also, companies may be incorporated as unlimited companies. In addition, companies incorporated outside Hong Kong which establish a branch office or place of business in Hong Kong must register at the Companies Registry as non-Hong Kong companies. Often, foreign companies which wish to carry on business in Hong Kong establish a local subsidiary to do so rather than a branch office, however this is not invariable practice. A number of factors may be relevant, including that a local subsidiary will have limited liability (although in practise the parent might provide guarantees).

Most companies incorporated in Hong Kong are limited by shares.

(a) Private Companies

By far the most numerous companies are private companies and the characteristics of a private company are that it must in its articles of association:-

- (i) restrict the right to transfer its shares;
- (ii) limit the number of its shareholders to 50 (excluding employees); and
- (iii) prohibit any invitation to the public to subscribe for any shares or debentures of the company.

(b) Public Companies

A public company is one which does not incorporate in its articles of association the characteristics of a private company as referred to above. Most (but not all) public companies are also listed on the Hong Kong Stock Exchange.

(c) Companies limited by Guarantee

Companies limited by guarantee are those which do not have shareholders as such but in relation to which the members of the company agree to contribute a particular amount in the event of the company being wound up. Typically, these are set up by non-commercial organizations e.g. clubs, charities and self-regulatory bodies.

(d) Unlimited Companies

Private and public companies may also be set up without limitation of liability, although this is uncommon. In this case, the shareholders of the company are liable for the debts of the company without limitation even if they have fully paid for their shares.

(e) Non-Hong Kong Companies

Companies incorporated outside Hong Kong are required to register at the Companies Registry if they establish a place of business in Hong Kong. This requires filing of a statutory form and also various corporate documents and, in some cases, accounts. Documents not in English or Chinese are required to be translated into English or Chinese.

3.2 What is the process for incorporation of a company?

A company is incorporated by filing a signed copy of its memorandum and articles of association at the Companies Registry together with (i) a statutory incorporation form which contains details of the type of company, the names and addresses of shareholders or members, the details of the first directors and the secretary and where appropriate the share capital structure; and (ii) a form of notice to the Business Registration Office, for the purpose of obtaining the company's business registration certificate in due course. The incorporation form also contains a confirmation that the requirements for incorporation of the company have been complied with.

The time taken for incorporation of a company is approximately 4 working days in respect of a private company limited by shares or one month in respect of other companies.

Most professional firms also have available "shelf" companies which are ready incorporated private limited companies which include standard memorandum and articles of association and which can be transferred to the client so that the company is available immediately for use without having to wait for the time required by the Companies Registry for incorporation.

3.3 How can a minority shareholder protect its interests?

There are certain very basic provisions in the Companies Ordinance which protect minority shareholders and also there are protections in the Listing Rules which provide protection to minority shareholders of listed companies. These provide for requirements for certain types of transaction to be notified or approved by shareholders and in some cases to be approved by the minority shareholders with the majority shareholders being unable to vote.

In addition, under the Companies Ordinance and at common law there are remedies which a minority shareholder may bring by way of derivative action either against the directors or the other shareholders who are engaging in conduct oppressive to the minorities. This is an action brought by the company against the relevant defendants.

In addition to this, minority shareholders may protect their interests by contractual provisions in a shareholders' agreement. Typically, these may include:-

- (a) rights of pre-emption in respect of the issue of shares and the transfer of shares;
- (b) put or call options in respect of shares;
- (c) rights to appoint and remove a particular number of directors;
- (d) rights of veto in respect of particular transactions;
- (e) requirements for a particular percentage of shareholders to approve particular transactions;
- (f) tag-along rights (i.e. a right on the part of the minority shareholder to require a majority shareholder to purchase a minority's shares in the event of a sale by the majority shareholder of its shareholding or a requirement to procure the purchaser to purchase some or all of the shares held by the minority shareholder);
- (g) deadlock resolution provisions.

Protections for minority shareholders can also be provided through the medium of arranging for minority shareholders to hold shares of a different class with particular rights granting minorities protection.

3.4 Are there any corporate governance norms?

In respect of listed companies, there is a code on corporate governance practices which sets out the principles of good corporate governance which include code provisions and recommended best practices. Listed companies are expected to comply with the code provisions but may deviate from them. The recommended best practices are for guidance only. Listed companies may also devise

their own code on corporate governance practices on such terms as they consider appropriate. In addition to the code, there are specific listing rules relevant to corporate governance, for example disclosure and shareholder approval requirements on transactions with connected parties.

In respect of companies which are regulated institutions (e.g. authorized financial institutions licensed by the Monetary Authority, insurance companies authorized by the Insurance Authority or entities holding licences from the Securities and Futures Commission) they are subject to various forms of memoranda, guidance notes and circulars issued by their regulators which address corporate governance issues.

In addition the Companies Ordinance does provide for certain basic corporate governance requirements. Some are procedural, others are substantive. Examples of the more important areas are as follows:-

- (a) Procedures for company name change and changes to the memorandum and articles of association.
- (b) Restrictions on a company giving financial assistance in connection with the purchase of its shares.
- (c) Regulations regarding a company's ability to buy back its own shares.
- (d) Rights of pre-emption in respect of the issue of shares.
- (e) Obligations to obtain shareholder approval for disposal of fixed assets.
- (f) Requirements for directors to disclose their interests in any transactions.
- (g) Restrictions on loans to or guarantees for directors or related parties.
- (h) Restrictions on the payment of dividends.
- (i) Procedures for reduction of capital.

In addition to the above, the detailed requirements for corporate governance are set out in the company's articles of association and these vary from company to company. A company may adopt the form of articles specified in the Companies Ordinance as Table A. The articles typically provide procedural matters covering the following:-

- (a) Status of the company as a private or public company.
- (b) Share capital.
- (c) Calls on shares.
- (d) Transfer and transmission of shares.
- (e) Alterations of capital.
- (f) Modification of rights attaching to shares.
- (g) Procedures for general meetings.

- (h) Directors, powers of directors, borrowing powers, managing directors, powers of managing directors.
- (i) Proceedings of directors and disqualification of directors.
- (j) Secretary.
- (k) Accounts.
- (l) Audit and appropriation of profits.

3.5 Are there any restrictions on a foreign-owned Hong Kong company from raising capital/debt from Hong Kong's markets?

A foreign-owned Hong Kong company may raise capital / debt from Hong Kong's markets but would have to comply with the relevant securities laws and listing rules.

Until fairly recently the Hong Kong Stock Exchange limited applications for initial public offerings to companies incorporated in a few specific jurisdictions, however the market has been opened up to applications from other jurisdictions, including Japan.

3.6 Can a Hong Kong company have foreign directors?

Yes, as regards directors. However, the company secretary must be a Hong Kong resident if he is an individual and if it is a body corporate, it must be a Hong Kong company or a company with an address in Hong Kong.

3.7 Are there any norms for the sharing of profits?

The normal ways in which profits are shared are based on the declaration of dividends to shareholders in accordance with the rights attaching to their shares. Among shareholders of a particular class, rights to dividends will rank *pari passu*. As to rights attaching to shares, see paragraph 3.8.

There is, however, a general (and important) provision in the Companies Ordinance which prohibits a company from distributing dividends other than out of its distributable profits. These are defined to mean the realized profits as per the latest audited accounts.

3.8 What type of shares can a company issue?

The most common type of shares which a company issues will be ordinary shares which rank *pari passu* both as regards dividends, voting and distribution in a liquidation.

Hong Kong law, however, is quite flexible about the types of shares which may be issued and this is a matter for agreement among the shareholders as to whether a company may have shares of more than one class and what the rights attaching to those shares are. The rights are normally set out in the articles of association. These may include:-

- (a) non-voting shares;
- (b) preference shares under which rights to dividends may be preferred to the rights to dividends on ordinary shares and which may or may not carry voting rights and with or without a preference as regards a distribution in liquidation;
- (c) deferred shares; these are shares which only rank for dividends or distribution in a liquidation until a particular amount has been paid on the ordinary shares. These may be voting or non-voting shares;
- (d) shares with fixed dividend rights; these are shares which are entitled to a fixed percentage dividend and which if not paid may either be cumulative or non-cumulative.

3.9 Are there any requirements in relation to the frequency and mode of holding board meetings?

There is no requirement regarding the frequency of the holding of board meetings except that listed companies are expected to hold board meetings at least quarterly. Typically, the articles will provide for how a board meeting should be convened i.e. what period of notice is required to be given to the directors and whether that notice may be waived and these will also provide for the quorum for board meetings i.e. the minimum number of directors required to attend for a valid board meeting. If allowed by the articles (but not otherwise), meetings may be held by telephone or teleconference facility.

3.10 What responsibilities and liabilities do company directors have?

Directors are responsible for ensuring that the provisions of the Companies Ordinance and other legislation relevant to a company's business and (in respect of listed companies) the Listing Rules are complied with.

In addition, they have the following fiduciary duties at common law:-

- (a) a director must act in good faith and for the benefit of the company as a whole;
- (b) he must use his powers for a proper purpose and for the benefit of the shareholders as a whole;
- (c) he should not delegate his powers except with proper authorization and must exercise

- independent judgment;
- (d) he must exercise care, skill and diligence;
 - (e) he should avoid conflicts between personal interests and the interests of the company;
 - (f) he should not enter into transactions in respect of which the directors have an interest except in compliance with the law;
 - (g) he should not gain an advantage from the use of his position as a director;
 - (h) he should not make unauthorized use of the company's property or information;
 - (i) he should not accept a personal benefit from third parties conferred because of his position as a director;
 - (j) he should observe the company's memorandum and articles;
 - (k) he should keep proper books of account.

These duties are elaborated in "A Guide on Directors' Duties" published by the Companies Registry and all directors are advised to read the latest version of this and acquaint themselves with the general duties of directors as outlined in the Guide.

4. LIQUIDATION

4.1 Please give a brief outline of the procedure involved in the winding up or liquidation of a company in Hong Kong. Are there any requirements specific to Hong Kong?

There broadly are two types of liquidation in Hong Kong: voluntary liquidation (i.e. members' voluntary liquidation or creditors' voluntary liquidation) and compulsory liquidation by the court.

(a) Members' voluntary liquidation

A members' voluntary liquidation is a solvent liquidation in which all the debts of the company are paid in full and the shareholders receive a return on the capital to which they have subscribed. Before any such procedure is initiated, the directors of the company are required to issue a certificate of solvency in the specified form.

The company must resolve at a members' meeting by special resolution (i.e. with a 75% majority) that the company be wound up, and such special resolution must be filed and notice of the passing of such resolution must be advertised in the Government Gazette. A liquidator will also be appointed at the same meeting to wind up the company's affairs and distribute its assets. The notice of appointment of the liquidator must also be published in the Government Gazette.

(b) Creditors' voluntary liquidation

A creditors' voluntary liquidation is a liquidation in which the shareholders and creditors of an insolvent company appoint a liquidator without any direct interference or control from either the court or any government department. This procedure is initiated by the directors and shareholders but is subject to the overall control by the creditors and the court. When the directors become aware that the company is insolvent, they should convene meetings of shareholders and creditors to put the company into liquidation. Procedurally, it would be done by shareholders passing a special resolution (i.e. with 75% majority) that the company be wound up and that a person be appointed as liquidator of the company. Such special resolution must be filed and advertised in the Government Gazette and the directors of the company must make a statement of the company's affairs showing its assets and liabilities (including a list of the company's creditors and an estimate of the amount of their claims).

A meeting of the creditors will then be convened. A notice of the meeting must be sent to all creditors and be advertised in the Government Gazette and in one Chinese language and one English language newspapers.

At the creditors' meeting, the directors' statement of affairs would be provided to the creditors and the creditors will consider the nomination of the liquidator (who may not be the same as the liquidator appointed by the shareholders. In such a case, the creditors' nomination would take precedence). The creditors' resolutions will be passed by a majority in value of those present and voting. The notice of appointment of liquidator is required to be published in the Government Gazette and delivered to the Companies Registrar.

(c) Compulsory winding-up

The compulsory liquidation procedure is conducted under the control of the Official Receiver and the court. It is substantially more formal than the voluntary liquidations mentioned above.

The process commences with the presentation of a winding up petition to the court. A petition may be presented by a creditor or the company itself. A shareholder can also present a petition on the grounds of justice or equity. There are several grounds on which a petition can be presented, but the most important ground is the company's inability to pay its debts (a company is deemed to be unable to pay its debt if it fails to satisfy a statutory demand served on it for a debt of not less than HK\$10,000 within 21 days).

If a winding up order is made by the court during the petition hearing, it would have an immediate effect, including that the powers of the directors would cease immediately.

4.2 Please give a brief outline of the bankruptcy proceedings in Hong Kong. Are there any requirements related to the filing specific to Hong Kong?

If a debtor fails to comply with a statutory demand served on him by his creditor for a debt of not less than HK\$10,000, the creditor can present a petition for a bankruptcy order against the debtor to the court. Such petition can also be presented by the debtor himself on the ground that he is unable to pay his debts. The petition has to be filed together with details of the debtor's failure to comply with the statutory demand, if applicable. The Official Receiver must be served with a copy of the bankruptcy petition.

If a bankruptcy order is made by the court during the petition hearing, such order must be advertised by the Official Receiver in the Government Gazette and the local newspapers.

5. FOREIGN INVESTMENT REGULATIONS

5.1 What are the sources of law regulating foreign investment in Hong Kong?

Hong Kong does not subject foreign investments to special regulatory regimes or requirements. Foreign companies setting up operations in Hong Kong do not face any special approval procedures and the procedural requirements are not materially different from those for local companies. Funds from profit or capital accounts may be freely repatriated and remitted overseas and there is no foreign exchange control.

100% foreign ownership of companies is generally permitted and common in Hong Kong, with very few foreign investment restrictions. Please see section 5.4 below.

5.2 What are the various methods in which foreign investment in Hong Kong is possible?

Please see section 5.1. In general, foreign investment may be made in the same way as domestic investment.

5.3 What is the current foreign direct investment policy?

Hong Kong is an open economy. Please see section 5.1.

5.4 What are the circumstances under which regulatory approval is required?

There are limitations on foreign investment in the television and sound broadcasting industries. In other regulated industries, such as securities and banking, foreign investment is not generally restricted, but the comparative regulatory system in the foreign jurisdiction may be a factor in obtaining licences from the relevant Hong Kong regulators.

5.5 Can a foreign company set up a wholly owned subsidiary in Hong Kong?

Yes.

5.6 How long do regulatory approvals take?

In the case of regulated industries, this varies. As regards the general timelines, please see sections 2 and 3 above.

5.7 Are there any restrictions on foreign ownership of land?

No.

6. LABOR

6.1 What are the principal regulations governing rights and obligations of employees?

The major piece of legislation governing rights and obligations of employees in Hong Kong is the Employment Ordinance. Other relevant legislation includes four Discrimination Ordinances (Sex Discrimination Ordinance, Disability Discrimination Ordinance, Family Status Discrimination Ordinance and Race Discrimination Ordinance), Immigration Ordinance (for visa issues), Mandatory Provident Fund Schemes Ordinance (for provision of mandatory retirement scheme), Occupational Retirement Schemes Ordinance (for provision of voluntary retirement scheme), Employees' Compensation Ordinance (for provision of insurance to employees to cover work injury), Minimum Wage Ordinance

(for regulating minimum wages payable to employees), Personal Data (Privacy) Ordinance (for handling personal data of employees) and the Inland Revenue Ordinance (for salaries tax reporting).

6.2 Are there any maximum working hours prescribed for employees?

Currently, there are no maximum working hours prescribed for employees in Hong Kong.

6.3 How can the services of an employee be terminated?

Generally the services of an employee can be terminated by giving a requisite notice. A “requisite notice” is a notice given to the employee with the prior period provided under the employment contract or in the absence of a specified notice period in the employment contract, a prior period of 1 month. If the employee is stated to be on probation, during the first month of probation, the employment can be terminated by either the employer or the employee without prior notice. The employer retains the right to terminate the employee for cause without prior notice if the employee commits serious misconduct. The employment of an employee who is pregnant, on maternity leave, on sick pay and injured at work pending assessment of worker’s compensation cannot be terminated (except for cause).

6.4 Are there mandatory requirements for grant of leave or public holidays?

Under the Employment Ordinance, the employee will be granted paid public holidays having completed 3 months of employment. Such employee would also be granted 7 to 14 days of paid annual leave, depending on his/her years of employment.

6.5 Can employment contracts contain restrictive covenants such as non-compete clauses?

Employment contracts can contain restrictive covenants such as non-compete clauses. However, such clauses must be reasonable and necessary to protect the legitimate interest of the employer. What is reasonable will depend on, amongst other things, the geographical scope of restriction, the restricted activities, the period of restriction and other relevant circumstances. Each case is assessed on a case by case basis. If the restrictive covenant is considered to be against public policy, then it would not be enforceable.

6.6 Can the employment contract compel employees to work for an establishment for a minimum period of time?

Under Hong Kong employment law, you can have an employment contract with a fixed term period. However, common law does not allow specific performance to be imposed on an employee. Therefore, the employee can still get out of the contract earlier than the agreed minimum period by breaching the contract.

6.7 Are women employees entitled to maternity leave?

A female employee is entitled to maternity leave of 10 weeks. An employee who has worked for not less than 40 weeks prior to the expected date of confinement is entitled to be paid during maternity leave. Maternity pay is 4/5th of normal wages. A female employee cannot be terminated (except for cause) from the time as she informs the employer of her pregnancy until she returns from her maternity leave.

6.8 Are male employees entitled to paternity leave?

Currently, there is no legislation requiring male employees to be provided with paternity leave. However, the government is considering introducing a statutory paternity leave regime in Hong Kong and a bill to enact the same is currently being drafted.

6.9 What are the requirements for the issuance of shares by a Hong Kong company to its employees/directors?

There are no requirements for issuance of shares by a company to its employees/directors. It is purely a contractual arrangement and there are certain relaxations from securities laws requirements relating to offering of shares to employees. If the company is listed in Hong Kong, certain listing rules requirements will also be relevant.

6.10 Can employees of a Hong Kong company be granted employee stock options in a foreign company?

Employees of a Hong Kong company can be granted employee stock options in a foreign company. There is currently no restriction nor particular requirement under Hong Kong law which prohibits the same. However, depending on how the stock options are structured, there may be regulatory issues. If the stock options involve stocks in a foreign company which is listed in Hong Kong, there are certain

listing rules requirements.

6.11 Are employee stock options eligible for favorable tax treatment?

No, generally employee stock options are not eligible for favourable tax treatment.

7. INTELLECTUAL PROPERTY

7.1 What types of intellectual property rights are protected in Hong Kong?

Hong Kong has a comprehensive system for the protection of intellectual property rights. The following types of intellectual property rights are protected in Hong Kong:-

1. Trade Marks (Trade Marks Ordinance Cap.559);
2. Patents (Patents Ordinance Cap.514);
3. Copyright (Copyright Ordinance Cap.528);
4. Designs (Registered Designs Ordinance Cap.522);
5. Plant varieties (Plant Varieties Protection Ordinance Cap.490);
6. Layout design of integrated circuits (Layout-Design (Topography) of Integrated Circuits Ordinance Cap.545).

Hong Kong law also protects other intangible rights such as confidential information and domain names. Trade marks, patents and designs must be registered with the Hong Kong Trade Marks, Patents and Designs Registry in order to be protected. Domain names also need to be registered but other intellectual property such as copyright and confidential information do not require registration. Unregistered trade marks, trade names, an individual's name or the get up of a particular product, including the packaging, may be protected under the common law action of passing off which can be used to prevent misrepresentations that cause confusion and damage to a plaintiff.

Intellectual property rights registered or protected in Hong Kong will not extend to the PRC and vice versa.

7.2 Are there any international treaties regarding intellectual property that Hong Kong is NOT a party?

Most notably, although the People's Republic of China is a party to the Madrid Agreement Concerning the International Registration of Marks and the Protocol Relating to the Madrid Agreement Concerning

the International Registration of Marks, applicability to Hong Kong has been deferred.

Hong Kong, as a special administrative region of the PRC is a party to many of the major International IP-related treaties via the PRC (since 1 July 1997), including:-

1. Berne Convention for the Protection of Literary and Artistic Works
2. Universal Copyright Convention
3. Paris Convention for the Protection of Industrial Property
4. Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms
5. WIPO Copyright Treaty
6. WIPO Performances and Phonograms Treaty
7. Patent Co-operation Treaty
8. Nice Agreement Concerning the International Classification of Goods and Services

7.3 Are there any regulations or guidelines by public institutions, such as the Fair Trade Commission or some other competition authority, in regard to intellectual property licences?

Hong Kong has traditionally taken a laissez-faire approach to commercial transactions and most terms of an intellectual property licence agreement are open to commercial negotiation and can be agreed between the parties. However, after many years of discussion and consultation, Hong Kong finally introduced a cross-sector competition law. The Competition Ordinance was gazetted on 14 June 2012 but is expected to be implemented in phases to allow the setting up of the Competition Commission and Tribunal. The substantive provisions are unlikely to come into effect before 2014. The Ordinance is similar to the EU regime and introduces two “conduct rules” which broadly prohibit anti-competitive agreements and the abuse of market power. The Ordinance will be supplemented by guidelines from the Competition Authority, block exemptions and other exclusions, including those based on public policy, international obligations, economic efficiencies or minimum turnover.

Agreements such as intellectual property licences may contain provisions that affect competition, such as restrictions on territories, customers, non-compete provisions, minimum pricing, supply sources or competing products. Whilst there may be legitimate reasons of efficiency for doing this, such agreements may also have negative effects on competition leading to price fixing, limitation of output or the partitioning of markets.

Whilst the law will obviously affect “horizontal” agreements between competitors including joint ventures and R&D agreements, at this stage, it is not clear to what extent the law will apply to

intellectual property agreements such as licences or “vertical agreements” generally, such as those between manufacturers, distributors and retailers. The Ordinance provides for a regime similar to the EU which allows the granting of “block exemptions” for certain categories of agreements and practices from the competition rules. However, we will need to wait until the further guidelines or the block exemptions are published.

8. EXCHANGE CONTROL

8.1 Are there any restrictions on the amount of local currency that may be brought into or taken out of Hong Kong?

There are no exchange controls in Hong Kong.

8.2 Are there any restrictions on the amount of foreign currency that may be brought into or taken out of Hong Kong?

There are no exchange controls in Hong Kong.

8.3 Are there any restrictions on the inflow or outflow of foreign exchange?

There are no exchange controls in Hong Kong.

9. M&A

9.1 What are the various methods of mergers and acquisitions available to Hong Kong companies?

Essentially, either acquisitions of shares in target companies or acquisitions of businesses or assets. Merger in the sense of combining two legal entities into one new entity (as opposed, say, to creating a new holding company for such entities) is not a feature of Hong Kong M&A.

9.2 What is the process and timing for each method?

Core documentation involved in a sale and purchase of a business or a company in Hong Kong typically includes the following:

- a confidentiality letter in which the parties undertake to keep confidential the actual transaction

and any information they may obtain during the due diligence process. In some cases, it may include a provision for exclusive negotiations for a particular period so that the purchaser knows that there will be no dual negotiations or auction type process;

- a due diligence questionnaire and report in relation to the business or company;
- a sale and purchase agreement that specifies the obligations and liabilities of each party in relation to the sale. This normally includes detailed representations and warranties regarding the business or company. The form of the sale and purchase agreement will depend largely upon whether shares or assets are being acquired. In a share purchase, all the company's obligations and liabilities will move across with the target company whereas in a business sale, subject to the Transfer of Business (Protection of Creditors) Ordinance ("Transfer of Business Ordinance"), the purchaser will normally be able to pick and choose which assets and liabilities it wishes to purchase;
- a disclosure letter in which the seller makes disclosures against the representations and warranties given by it to the purchaser in the sale and purchase agreement;
- share transfer forms where the sale and purchase involves the sale of shares, and bought and sold notes if these are shares in a Hong Kong company;
- a notice under the Transfer of Business Ordinance in the case of the sale of a business;
- other documentation may be required, such as a press announcement, and, possibly, a circular to shareholders (and possibly shareholder approvals), if the sale or purchase is by, or involves, a company listed on the Stock Exchange (or one of its group companies);
- disclosures to the company and the Stock Exchange of the acquisition of shares in a case where the target company is listed;
- if a public company is the target and therefore the Takeover Code applies and a general offer is made, then offer documentation would need to be produced in compliance with the Takeover Code (which contains detailed timeline requirements);
- other requirements will depend on the circumstances, for example whether a regulated industry is involved.

9.3 What are the criteria for determining which method is most suited to a particular case?

In terms of share acquisition versus business or assets acquisition, a number of criteria may be relevant, for example, relative simplicity of acquisition of shares (where there is continuance of the existing legal entity) which carry no separate liability for the purchaser (provided the shares are fully paid up) and the ability of an acquiror in a business / assets acquisition to pick and choose which assets to acquire and, subject to the comments immediately below, which liabilities to assume.

The Transfer of Business Ordinance provides that whenever a business is transferred (as opposed to

a share acquisition), the acquiror shall, notwithstanding any agreement to the contrary, become liable for all the debts and obligations arising out of the carrying on of business by the seller unless the procedures set down in that ordinance are followed. These procedures require the parties to publish a notice of transfer (setting out prescribed particulars of the transfer) not more than four months but not less than one month before the date the transfer takes place. Effectively, the purchaser ceases to be liable for all such obligations of the seller with effect from the date on which the notice of transfer becomes complete, which occurs upon the expiration of one month after the date of the last publication of the notice, unless within that period a creditor effects proceedings against the seller in respect of any liability of the seller arising out of the carrying on of the business. Under the Transfer of Business Ordinance, the purchaser is entitled to be indemnified by the seller for all amounts for which the purchaser is made liable under that ordinance and for which it would not otherwise be liable, although in most cases an express indemnity provision is also included in the contractual documents between the parties.

9.4 What are the additional requirements, if any, if one of the companies involved in the restructuring is listed on the stock exchange in Hong Kong?

The Stock Exchange does not normally take a primary role in relation to the sale or purchase of shares in listed companies or in respect of takeover transactions. It may, however, investigate the listed company's suitability for listing following the takeover or merger. In particular, the Stock Exchange will be concerned to see that at least 25% of the share capital of the listed company (being the minimum public float, subject to exceptions) remains in the public's hands following the relevant transaction. In addition, the Stock Exchange will also scrutinise reverse takeovers or back-door listings.

Acquisitions and disposals by a listed company or one of its group members, and transactions with connected persons of a listed company, are primarily regulated by Chapters 14 and 14A of the Listing Rules respectively. The Stock Exchange has the responsibility of ensuring that all the requirements of the Listing Rules are complied with in this regard.

Under Chapter 14 of the Listing Rules, transactions are categorised in accordance with specified percentage ratios, and the consequences of a transaction depend upon the category into which it falls. There are five percentage ratios, which compare:

- the total assets which are the subject of the transaction with the total assets of the listed group;
- the net profit attributable to the assets which are the subject of the transaction with the net

- profit of the listed group;
- the revenue attributable to the assets which are the subject of the transaction with the revenue of the listed group;
- the aggregate value of consideration given/received with the total market capitalisation of the listed group; and
- the value of any equity capital issued as consideration by an acquiring listed company with the value of its equity capital previously in issue.

There are complex provisions relating to the tests and the calculations to be made, including a requirement for aggregation of transactions in certain circumstances and requirements where a company becomes or ceases to be a subsidiary or where a non-wholly owned subsidiary effects a transaction.

The classes of transaction and the relevant requirements are as follows:

- reverse takeover: this is an acquisition of assets which, in the opinion of the Stock Exchange, constitutes, or is part of a transaction or arrangement which constitute, an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirements for new listings under the Listing Rules. The Stock Exchange will treat a company proposing a reverse takeover as if it were a new listing applicant, and the transaction must be made conditional upon approval by the shareholders of the company in general meeting. No written shareholders' approval will be accepted in lieu of holding a general meeting;
- very substantial acquisition: this is an acquisition of assets where any percentage ratio is 100% or more. The acquisition must be made conditional upon approval by the shareholders of the company in general meeting. No written shareholders' approval will be accepted in lieu of holding a general meeting;
- very substantial disposal: this is a disposal of assets where any percentage ratio is 75% or more. The disposal must be made conditional upon approval by the shareholders of the company in general meeting. No written shareholders' approval will be accepted in lieu of holding a general meeting;
- major transaction: this is any acquisition or realisation of assets where any percentage ratio is 25% or more, but less than 100% for an acquisition or 75% for a disposal. It must be made conditional upon shareholders' approval, which may be obtained either by holding a general meeting of the company's shareholders or, if no shareholder is required to abstain from voting if the company were to convene a general meeting for the approval of the transaction, by written approval of a closely allied group of shareholders holding 50% or more of the nominal value of the company's voting securities;
- discloseable transaction: this includes any acquisition or realisation of assets where any

- percentage ratio is 5% or more but is less than 25%;
- share transaction: this is an acquisition of assets where all the percentage ratios are less than 5% but the consideration includes securities for which listing will be sought. Discloseable transactions and share transactions generally give rise to disclosure rather than shareholders' approval requirements; and
- connected transaction: this includes widely drawn and complex provisions governing transactions with related parties. A connected transaction may require disclosure and also possibly shareholders' approval, depending on the circumstances.

9.5 What are the regulations restricting the acquisition of a certain percentage of shares in a company and when do compulsory takeover regulations apply?

The Takeover Code applies to public companies in Hong Kong and companies with a primary listing of their equity securities in Hong Kong. The Code regulates acquisitions of shares in an offeree company which change its control, currently defined as a holding, or aggregate holdings, of 30% or more of the voting rights of a company, irrespective of whether that holding or holdings gives de facto control. The Takeover Code applies not only to the offeror and the offeree company, but also to those persons "acting in concert" with the offeror. Rule 26 of the Code requires the making of a mandatory general offer to all shareholders of the offeree company (unless a waiver has been granted by the executive director of the corporate finance division of the Securities and Futures Commission), where a person or a group of persons acting in concert:

- acquires control of a company (as noted, meaning 30% or more of the voting rights), whether by a series of transactions over a period of time, or not; or
- when already holding between 30% and 50% of the voting rights of a company, acquires more than 2% of the voting rights in the target company in a 12-month period from the date of the relevant acquisition.

Separately, it should be noted that there is complex legislation in Hong Kong relating to disclosure of interests in listed companies (which involves much lower thresholds).

9.6 Would the above forms of restructuring also be available to foreign companies?

In general, local legislation, regulations and practice (save only for matters specific to Hong Kong incorporated companies) also apply to foreign companies participating in the market (and of course the laws and regulations of the jurisdiction of incorporation of such companies are also likely to be

relevant).

9.7 Is there any legislation or other form of regulation which applies to restrict the potential anti-competitive results of a sale or acquisition of a business or company within Hong Kong?

Before the enactment of the Competition Ordinance in June 2012, Hong Kong has only regulated competition in telecommunications and broadcasting industries under specific relevant legislation. The Competition Ordinance, the substantive provisions of which are expected to come into force in 2014, prohibits anti-competitive agreements and abuse of substantial market power across all industries, and establishes a merger control regime prohibiting mergers or acquisitions that have (or are likely to have) the effect of substantially lessening competition. For the time being the merger rule only applies where there is a change of control in a telecommunications carrier in Hong Kong; the scope of application will be reviewed and may be broadened to other industries in the future.

Competition legislation of other jurisdictions can be relevant to Hong Kong M&A. For example, in an acquisition of a Hong Kong company with businesses in mainland PRC, the mainland PRC anti-monopoly law may be relevant.

10. TAX

10.1 What determines the extent of a company's liability to pay Hong Kong income tax?

Hong Kong profits tax is charged on profits that arise in or are derived from Hong Kong from a trade, profession or business carried on in Hong Kong.

Certain kinds of income accruing to a person ("person" includes a corporation, partnership and trustee, whether incorporated or unincorporated) who does not otherwise carry on a trade, profession or business in Hong Kong can be deemed to be taxable in Hong Kong. These can include:-

- Fees for exhibition or use in Hong Kong of films or tapes or sound recordings or any advertising material connected with such film, tape or recording;
- Royalties for use of or right to use intellectual property rights in Hong Kong and, in some circumstances, outside Hong Kong;
- Grants, subsidies or financial assistance to a business carried on in Hong Kong;
- Rentals for use of property in Hong Kong;
- Interest accruing to a financial institution through or from its business in Hong Kong and profits

- made by a financial institution on sale or redemption of certain commercial paper;
- Interest received in respect of funds of a business carried on in Hong Kong not being otherwise exempt;
- Hong Kong sourced profits on sale or redemption of certain commercial paper, except in a non-business context; and
- Consideration for the transfer of certain rights to receive income from property.

10.2 How is residence treated for tax purposes?

The residence of the taxpayer is generally irrelevant for tax purposes.

The residence of the person to whom payment is accrued is, in certain circumstances, relevant to the withholding obligation of the payer (please see section 10.7 below).

10.3 What is the corporate tax rate and how is it applied?

The rate of profits tax is currently 16.5% for corporations and 15% for taxpayers other than corporations.

Profits tax is, generally speaking, charged on assessable profits after deduction of expenses (other than capital expenditure) incurred in the production of profits taxable in Hong Kong.

10.4 What is the tax rate applicable to foreign companies on their income earned in Hong Kong?

The normal rate of profits tax (please see section 10.3 above) applies.

10.5 What other taxes are payable in Hong Kong?

In addition to profits tax, the principal taxes levied in Hong Kong are:-

- (a) Salaries tax which is charged on an individual's Hong Kong-sourced employment income, income from an office in Hong Kong or Hong Kong-sourced pension.
- (b) Property tax which is charged on the assessable value of any land or buildings in Hong Kong.
- (c) Stamp duty which is charged on the following documents:-
 - Conveyances on sale of property;
 - Agreements for sale of residential property;
 - Leases of property exceeding one year;

- Transfers of Hong Kong stock;
- Hong Kong bearer instruments.

Other taxes such as duties charged on dutiable commodities (being liquor, tobacco, hydrocarbon oil and methyl alcohol) and vehicle registration fees are also charged in Hong Kong.

10.6 Is there a tax on dividends?

Hong Kong does not impose tax on dividends.

10.7 Are payments subject to withholding tax?

Certain payments can be subject to withholding tax if made to a non-resident person. These can include:-

- Payments made to a non-resident person where the non-resident person is chargeable to profits tax in respect of its/his profits arising in or derived from Hong Kong from any trade, profession or business carried on in Hong Kong and the person which/who makes payment is its/his agent.
- Royalties paid to a non-resident person for the use of or right to use intellectual property rights in Hong Kong and, in some circumstances, outside Hong Kong.
- Sale proceeds where a person sells any goods in Hong Kong on behalf of a non-resident person.
- Payments made in respect of the performance in Hong Kong by a non-resident entertainer or sportsman of an activity in his character as entertainer or sportsman or in connection with a commercial occasion or event.

An employer is required to withhold money (or money's worth) payable to an employee who is about to leave Hong Kong for a period exceeding one month.

10.8 Is capital gains tax payable in Hong Kong?

Hong Kong does not impose tax on capital gains.

10.9 Is there a tax treaty between Hong Kong and Japan?

Yes, the Comprehensive Double Tax Treaty signed between Japan and Hong Kong on 9th November 2010 (as supplemented by an exchange of Notes dated 31st March 2012) came into effect in Hong

Kong as from the year of assessment 2012/2013.

11 DISPUTE RESOLUTION

11.1 Please give a brief outline of the civil procedure in Hong Kong.

Civil proceedings in Hong Kong are generally commenced by a party issuing a Writ of Summons and serving the same on the defendant. The Writ would usually be endorsed with a Statement of Claim which would set out the factual background in support of the claim.

If the defendant wishes to dispute a claim, he must file an Acknowledgment of Service form stating his intention to contest the claim and then a Defence within the relevant specified period.

Then, the plaintiff may file a Reply to the Defence and if the defendant has made a counterclaim against the plaintiff, the plaintiff must file a Defence to the Counterclaim within the specified period. These documents, namely the Statement of Claim, Defence, Counterclaim and Reply, are collectively known as the pleadings.

After close of pleadings, the plaintiff and defendant must undergo the discovery process whereby lists of all the documents which are relevant (which may advance or damage the plaintiff or defendant's case) and material to the facts and matters in dispute would be exchanged and copies of such documents would be made available to the other party for inspection. Then, the parties would exchange witness statements of fact and, if appropriate, expert reports.

Either party can then proceed to set the action down for trial. At trial, the plaintiff must prove its claim on the balance of probabilities by his factual (and expert), witnesses and documentary evidence.

Civil Justice Reform

The civil justice reform came into effect on 2 April 2009 in Hong Kong. Under the reform, the new court rules aim to improve cost-effectiveness and reduce complexity and delays in court proceedings. The new rules contains a list of factors, called "underlying objectives", which the court must consider and give effect to whenever exercising its powers or interpreting the court rules or a practice direction. The new rules also place an obligation on the parties and their legal representatives to assist the court to further the underlying objectives.

A specific duty is placed on the court to further the underlying objectives by actively managing cases. The court has the power to intervene in a case and make orders of its own motion, rather than sitting

back and letting the parties run the case as they think fit. The court also has greater control over evidence, for example by being able to limit the number of witnesses and order the appointment of a single joint expert for both parties.

Under its case management powers, the court is to encourage and facilitate the use of alternative dispute resolution procedures such as mediation. The court may make adverse costs orders against a party which unreasonably refuses to mediate.

11.2 How are foreign judgments enforced in Hong Kong?

There are two mutually exclusive methods to enforce foreign judgments in Hong Kong:-

- (a) the common law regime; or
- (b) the statutory regime under the Foreign Judgments (Reciprocal Enforcement) Ordinance (Cap. 319).

The first method is essentially commencing a separate action by a Writ of Summons with the foreign judgment as the cause of action. The plaintiff would then usually issue a summons for summary judgment. For a foreign judgment to be enforced in Hong Kong, the judgment must be: final and conclusive, rendered by a court considered by Hong Kong law to have had competent jurisdiction, not procured by fraud, not rendered contrary to the rules of natural justice, and not contrary to public policy.

The regime under the Foreign Judgments (Reciprocal Enforcement) Ordinance involves registering the foreign judgment with the Hong Kong Court so that it may be enforced in Hong Kong in the same way as a Hong Kong judgment. A foreign judgment can be registered in Hong Kong only if there are reciprocal arrangements for the recognition and enforcement of Hong Kong judgments between Hong Kong and the country where the judgment was originally given.

Enforcement of Mainland China's Judgments in Hong Kong is under a separate regime - the Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap. 597).

11.3 What are the alternative methods of dispute resolution available in Hong Kong?

The common options of alternative dispute resolution in Hong Kong are:-

- (a) Negotiation - a process in which no neutral third party is involved to facilitate the resolution.

- (b) Conciliation - a neutral third party seeks to get the parties to agree on a procedure by which they will attempt to resolve their dispute. A conciliator acts as an organiser and will not usually involve himself/herself with the dispute other than perhaps by assisting the parties to identify the issues involved.
- (c) Mediation - mediation is similar to conciliation. The mediator encourages the parties themselves to reach a settlement. The mediator is actively involved in negotiating, providing suggestions to assist the parties towards resolution, but does not impose his/her own opinions but rather encourages a resolution by the parties themselves.
Under the civil justice reform, Practice Direction 31 on Mediation became effective on 1 January 2010. This requires parties to legal proceedings to consider using mediation to resolve their dispute. If the court considers that a party has unreasonably refused to engage in mediation, it may make an adverse costs order against that party.
- (d) Arbitration - a legal process where arbitrator(s) would hear the parties' case and make an award which is final and binding on the parties and which can only be challenged in very exceptional circumstances.

11.4 How are arbitral awards enforced in Hong Kong?

An arbitral award, whether made in or outside Hong Kong, may be enforced in Hong Kong in the same manner as a court judgment, once the court has given leave to enforce the award, as provided in the Arbitration Ordinance (Cap. 341). The relevant application for leave is made on paper without notice to the party against whom the enforcement is sought.

It is also possible to enforce an award made in Hong Kong by starting fresh proceedings before the Hong Kong courts relying on the award as creating a debt. The applicant may use the short form summary judgment procedure (i.e. judgment without going to a full trial), on the ground that a respondent has no defence to the claim.

11.5 What are the grounds on which an arbitration award can be challenged in the courts in Hong Kong?

An arbitration award made in Hong Kong (and there is now no distinction between international and domestic awards) may be set aside on grounds relating to lack of jurisdiction, incapacity, public policy, improper constitution of the arbitral tribunal, serious procedural irregularity, or by way of appeal on a question of law (but no appeal lies on questions of fact).

(As of June, 2013)

This article is intended to provide only general, non-specific legal information and does not purport to give a legal opinion or advice on specific facts.