

DEACONS
的近律師行

Managing risks in challenging times



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This brochure aims to assist companies in managing risks and provide guidance for companies on various legal implications involved when making significant management decisions during a time of economic crisis. The contents are divided into four sections covering "Companies ceasing business operations", "Employment - redundancy", "Termination of commercial leases" and "Tax" respectively. The information provided is by no means exhaustive, and you should seek professional advice on the specific areas relevant to your business decisions.

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A Company ceasing business operations

1 What are the ways in which a Hong Kong-incorporated company may cease to operate or be dissolved?

Assuming all requisite conditions are met, the company may be:

- (1) made dormant (i.e. company ceases business operations but is not dissolved), and may be reactivated if so desired;
- (2) deregistered and dissolved, therefore ceases to exist; or
- (3) wound up and dissolved, therefore ceases to exist.

2 What are the benefits in rendering a company dormant?

A dormant company is not required to prepare and file annual returns or hold annual general meetings, and does not need to have financial statements prepared and audited. A dormant company may be reactivated, as and when desired, to carry on the desired business.

3 When will a company become dormant?

If a company passes a special resolution declaring that it will become dormant, the company becomes dormant as from the date of delivery of the special resolution to the Registrar of Companies (Registrar), or a later date that is specified in the special resolution.

4 Can any company apply to be made dormant?

No. Only a “qualified” private company may apply to the Registrar to be made dormant. A “qualified” company is one which, as at the date of its special resolution and any time in the 5 years immediately before such date:

- is not an authorised institution as defined under the Banking Ordinance;
- is not an insurer as defined under the Insurance Companies Ordinance;
- is not licensed under the Securities and Futures Ordinance (SFO) to carry on a regulated activity;
- is not an associated entity of a company licensed under the SFO to carry on a regulated activity;
- is not an approved trustee as defined under the Mandatory Provident Fund Schemes Ordinance; and
- does not have a subsidiary which is any of the above types of companies.

5 How may a dormant company be reactivated?

A dormant company may be reactivated and cease to be dormant, by passing a special resolution declaring that the company intends to enter into an accounting transaction, and delivering it to the Registrar for registration. The company ceases to be dormant as from the date such special resolution is delivered to the Registrar.

6 What is an accounting transaction?

An “accounting transaction”, in relation to a company, means a transaction that is required by the Companies Ordinance to be entered in the company’s accounting records, save and except a transaction arising from the payment of any fee that the company is required by any law to pay (such as business registration fee).

7 Can any company apply for deregistration?

No. Only a “qualified” private company or a “qualified” company limited by guarantee, which is a defunct solvent company, may apply for deregistration. A “qualified” entity for deregistration is largely one which is “qualified” for dormancy (see paragraph A4 above) and not registered as a trust company under the Trustee Ordinance Cap.29.

8 What are the conditions and requirements for a company to make an application for deregistration?

The company must meet the following conditions before making an application for deregistration:

- (1) all members of the company agree to the deregistration;
- (2) the company has not commenced operation or business, or has not been in operation or carried on business during the 3 months immediately before the application;
- (3) the company has no outstanding liabilities;
- (4) the company is not a party to any legal proceedings;
- (5) the company’s assets do not consist of any immovable property situate in Hong Kong;
- (6) if the company is a holding company, none of its subsidiary’s assets consists of any immovable property situate in Hong Kong; and if the company is a holding company, none of its subsidiary’s assets consists of any immovable property situate in Hong Kong; and
- (7) the company has obtained a "Notice of No Objection to a Company being Deregistered" from the Commissioner of Inland Revenue (Notice of No Objection).

An application for deregistration in the specified form must be delivered to the Registrar within 3 months from the date of issue of the Notice of No Objection, together with the required fee and the Notice of No Objection.

If the application is in order, the Registrar will publish a notice of the proposed deregistration in the Gazette. If no objection to the deregistration is received by the end of the 3 months after the date of publication of the notice, the Registrar may publish in the Gazette another notice declaring the company to be deregistered on the date of the latter notice.

9 What is winding-up?

Winding-up is the process of appointing a liquidator who will settle the accounts, pay off the company’s debts (if any), liquidate the assets of the company and distribute the surplus assets (if any) to members, and ensuring that the company is completely dissolved.

10 What are the differences between deregistration and winding up?

Both processes will result in the dissolution of a company.

Winding-up is the process of settling the accounts and liquidating the assets of a company to make distribution of the net assets to members and dissolve the company. The procedures are laid down in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32).

A defunct solvent company which meets the required conditions mentioned under paragraph A8 above may be dissolved by applying for deregistration. Deregistration is a relatively simple, inexpensive and quick procedure for dissolving a defunct solvent company.

Note that unlike when a company is wound up or liquidated, a deregistered private company or company limited by guarantee may be restored or reinstated by the Registrar without involving the court, if the deregistration was a mistake.

Generally speaking, deregistration is unsuitable for a company which has substantial assets or a large issued capital, without first transferring the assets out of the company's ownership, and reducing its issued capital via a share buy-back or court-free capital reduction exercise.

The procedures involved in deregistration or winding-up are rather complex. You are strongly advised to engage the services of a professional firm if you are considering closing down your company in Hong Kong.

B Employment – redundancy

1 Can an employer dismiss an employee by reason of redundancy?

Under the Employment Ordinance (EO), an employee is taken to be dismissed on the ground of redundancy if the employer has ceased or intends to cease his business in the place where the employee was employed, or if the requirement of the business for the employee to carry out work of a particular kind, or for the employee to carry out work of a particular kind in the place where the employee was employed, ceases or diminishes or is expected to cease or diminish. In those situations, an employer will be required to pay a statutory severance payment to an employee who has been continuously employed for not less than 24 months.

2 Are there any statutory restrictions on the termination of an employment contract?

There are several statutory restrictions which will make it unlawful for an employer to dismiss an employee even on the ground of redundancy, and they are:

- when a female employee has been confirmed pregnant and has served a notice of pregnancy on the employer (up until and including the day she is due to return to work on the expiry of her maternity leave or the date of cessation of pregnancy);
- when an employee is on statutory paid sick leave;
- if one of the reasons for dismissing an employee is by reason of his giving evidence or information in any proceedings or inquiry in connection with the enforcement of the EO, work accidents or breach of work legislation;

- if one of the reasons for dismissing an employee is due to his trade union membership and activities, disability, gender, marital status, pregnancy, race, or family status; or
- when an employee is suffered from work-related injury or occupational diseases but he has not entered into an agreement with the employer for employee's compensation or before the issue of a certificate of assessment.

3 Are there any other termination payments?

Apart from the statutory severance payment, upon the termination of an employee, employers must also make the termination payments to the dismissed employee. Termination payments may differ depending on the length of service, the terms of the employment contract and the reason for termination. These payments usually include the following:

- outstanding wages;
- payment in lieu of notice (if applicable);
- payment in lieu of any accrued but untaken annual leave;
- any outstanding sum of end of year payment, and pro rata end of year payment for the current payment period (if any); and
- other payments under the employment contract, such as gratuity, provident fund, etc.

An employer who fails to pay the termination payments when they become due is liable to prosecution and, upon conviction, to pay a fine of HK\$350,000 and imprisonment for three years.

In addition to terminal payments and compensation, employees who are unreasonably or unlawfully dismissed may claim reinstatement or re-engagement. If successful, the Labour Tribunal may make an order for reinstatement or re-engagement or an award of terminal payments and/or compensation not exceeding HK\$150,000.

4 If an employee is dismissed due to redundancy, should an employer pay an employee both the severance payment and the long service payment?

An employee who is dismissed by reason of redundancy is eligible for severance payment only and is not eligible for long service payment.

5 What is the formula for the calculation of severance payment?

The amount of statutory severance payment is two-thirds of the employee's last full month's wages or two-thirds of HK\$22,500, whichever is less, multiplied by the number of years of service. The current maximum severance payment payable is HK\$390,000.

Currently, an employer can offset the statutory severance payment that an employee is entitled to against the accrued benefits derived from the employer's contributions to the mandatory provident fund scheme or the occupational retirement scheme. However, the off-setting mechanism may be abolished in the near future.

C Termination of commercial leases

1 If a business wishes to downsize or cease its operations, can it terminate its lease before the expiration of the lease term?

A tenant is contractually bound by the terms of the lease. Therefore, the tenant cannot unilaterally terminate the lease before its expiry unless it contains a break clause.

Commercial leases in Hong Kong are generally in favour of landlords. They do not usually contain a break clause allowing the tenant to terminate the lease before the expiration of the lease term. In addition, there are usually provisions in commercial leases which prohibit alienation. Alienation refers to the tenant's right to assign, sublet, change control and change business name. These restrictions will apply unless the tenant has obtained the landlord's prior consent.

In the absence of a break clause or right to alienate, the only option available to a tenant who wants to end a lease before the expiration of the term is to offer to surrender the lease to the landlord on mutually acceptable terms.

The landlord is free to accept or reject the tenant's offer. If the tenant breaks the lease without the landlord's consent, then the consequence of a breach follows. The landlord would be entitled to claim damages against the tenant, which includes the following:

- forfeiture of the deposit (depending on the terms of the lease, in some cases, the court may allow credit to be given to the deposit when the loss and damage are assessed);
- rent and charges that the landlord would have received during the remainder of the term, subject to a duty to mitigate; and
- management fees, rates, cost of repair due to damage to the leased property by the tenant, utility charges payable on the leased property, stamp duty and estate agent's commission spent on re-letting the leased property, etc.

D Tax

1 Are there any exit taxes or charges if I choose to delocalise/redomicile my business?

There are no capital gains taxes in Hong Kong. Hong Kong is a free port with no capital controls. It is in general very straightforward to transfer movable business assets in and out of Hong Kong. Note, however, that the transfer of shares in a Hong Kong incorporated company or otherwise in a company listed on the Hong Kong Stock Exchange and the transfer of Hong Kong immovable property will in the ordinary course give rise to a charge to ad valorem stamp duty. Those charges may in principle be avoided or otherwise mitigated by careful tax planning.

2 Will there be adverse tax consequences if I cease being resident in Hong Kong?

With relatively few exceptions, such as Singapore and Malaysia, most developed jurisdictions tax their residents on a worldwide basis, as opposed to on a territorial basis. That means that if you become resident in, say, Australia or the United Kingdom, you will in the ordinary course be taxable in those jurisdictions on your worldwide income, and not just your locally sourced income.

You may therefore find that you and/or your business will pay more tax in the jurisdiction in which you choose to delocalise/redomicile. That said, there are tax planning opportunities available to assist you in mitigating income tax and/or capital gains tax that may arise in other jurisdictions with respect to Hong Kong situate assets and/or Hong Kong source income streams.

In particular, you may find it preferable to keep certain elements of your business or personal assets in Hong Kong in order to continue to benefit from a relatively commercially-friendly environment and low headline rates of tax.

3 Should I move all my business assets out of Hong Kong if I wish to relocate/redomicile my business?

Ultimately, this will be a commercial decision for you to make; however, you may find it tax-efficient to keep certain assets such as intellectual property rights and other intangibles in Hong Kong, as such assets may readily be utilised to achieve your tax and commercial planning objectives.

4 Will my personal or business trust arrangements be affected if I leave Hong Kong?

Most developed jurisdictions have aggressive taxation policies with respect to trusts. That said, tax planning is usually available and viable to mitigate any tax risks that may arise when you become a resident in a jurisdiction outside of Hong Kong with respect to any trusts of which you are a settlor, beneficiary, and/or trustee.

5 Will there be consequences for inheritance tax/estate planning if I leave Hong Kong?

This will in practice depend on your chosen destination. If you choose to relocate to the United Kingdom, there may be inheritance tax payable on some or all of your estate should you die while a resident and/or domiciled in that jurisdiction. Many civil law jurisdictions such as France and Italy have forced heirship rules that may override the terms of your will. You should seek estate planning advice as soon as you contemplate relocation. Careful planning can assist in mitigating or eliminating the risk of unforeseen changes to your estate and succession planning arrangements.

Trust arrangements may also be helpful to ensure that any member of your family who decides to remain in Hong Kong is well looked after in a sustainable and tax efficient manner.

6 What if I have bonus shares, or securities or benefits from an employment related share scheme that will vest or are likely to vest after I have left Hong Kong?

Amounts referable to your performance in employment while in Hong Kong, or the satisfaction of vesting conditions while you were in Hong Kong, will in general remain taxable in Hong Kong. That means when the shares or bonus amounts vest, you may have a charge to Hong Kong tax for which you must account. You may, however, be protected from double taxation by a Double Tax Treaty having effect or by virtue of being granted a unilateral credit for Hong Kong tax paid in your jurisdiction of residence.

7 What about my pension?

This will depend on how your pension was structured, and on what kinds of benefits it will pay to you. Generally speaking, Hong Kong taxes pension payments sourced in Hong Kong. You may, however, depending on the jurisdiction in which you choose to become resident, be granted a tax credit for tax paid in Hong Kong or otherwise exempted from local tax entirely (i.e., only taxable in Hong Kong with respect to the pension payment).

8 What if I have an unresolved audit or dispute with the Hong Kong Inland Revenue Department?

We would recommend that these be resolved as a matter of priority before your departure. The Inland Revenue Department (IRD) has wide-ranging information-gathering and enforcement powers, including applying for departure prevention orders that could prevent you from leaving Hong Kong. Further, Hong Kong's growing Double Tax Treaty network means that the IRD may attempt to collaborate with the revenue authorities of the jurisdiction in which you become resident with a view to obtaining information or seeking to recover tax debts.

The IRD can block the dissolution of a company incorporated in Hong Kong if it considers that the company owes it a tax debt, or has otherwise been non-compliant with its tax administration obligations.

9 Does an employer who dismisses or makes redundant employees in Hong Kong have any tax reporting requirements?

Yes, an employer is required to notify the IRD in writing if an employee leaves employment or otherwise departs Hong Kong permanently. Under such circumstances, employers may be required to withhold wages due to employees.

Want to know more?

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