Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (c-redom-consult@fstb.gov.hk)

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Division 4, Financial Services Branch
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
66 Queensway,
Hong Kong

Dear Sirs,

Public Consultation on Proposed Company Re-domiciliation Regime in Hong Kong

Thank you for inviting the views of the Hong Kong Institute of Certified Public Accountants ("the Institute") on the proposed company re-domiciliation ("Re-dom") regime in Hong Kong. Several of the Institute's committees, including the Taxation Faculty Executive Committee ("TFEC"), the Restructuring and Insolvency Faculty Executive Committee and the Small and Medium Practices Committee have reviewed the proposals in the consultation paper ("CP") and have indicated their views. We also appreciate the opportunity to attend an engagement session with government representatives to understand more about the proposal and to be able to convey our views, which are set out below.

General comments

While we are generally supportive of the proposal, we have some views in relation to how it will be implemented in practice and comments on other issues that the government should consider in drawing up more detailed proposals.

We suggest that the focus should be on facilitating Re-dom from jurisdictions with similar company law basis (e.g., common law) such as Bermuda, the British Virgin Islands and the Cayman Islands, as soon as possible. These will be the source of most Re-doms and will ensure the immediate success and utilisation of the proposals. One major international insurance company, for example, is already reported as wanting to re-domicile to Hong Kong to take advantage of opportunities in the Greater Bay Area. If it is to be expanded to less legally similar jurisdictions, this should be done later and not hold up the process.

The financial regulators, the Hong Kong Monetary Authority, Securities and Futures Commission and Insurance Authority, should engage early and provide clear guidance on how they will regulate the re-domiciled companies. This should be a priority, again to make sure the new provisions are utilised and successful.

In our view, caution should be exercised in relation to applications from companies incorporated in countries subject to United Nation sanctions and jurisdictions regarded as high risk from an anti-money laundering/ counter-terrorism financing perspective, such as those subject to a Call for Action by the Financial Action Task Force ("FATF") or a call on its members and other jurisdictions to apply

countermeasures, or apply enhanced due diligence measures.

More, generally, Hong Kong should think twice about facilitating Re-doms by companies with a history of poor corporate governance, abuses of shareholders and/or convictions for relevant offences.

We note from the engagement session that the government will consider applications for Re-doms only from companies incorporated in jurisdictions that have an outward Re-dom regime. While this is understandable from the point of view of being able to resolve exit-related issues more readily, it may also be quite limiting. Even if this is the position at the outset of implementation of the proposed Re-dom regime, we would suggest this feature or condition should not be cast in stone, and should not be made a statutory element of the regime.

We note that the government is not proposing an economic substance test or other similar restrictions in relation to companies wishing to apply for Re-dom. We support this as being more inclusive and beneficial to the effectiveness of the proposals.

We note the proposals do not refer to the possible accounting and auditing issues arising from Re-dom. We provide comments on some of the key issues below, but, at the same time, the government may wish to reach out directly to the companies that have shown an interest in re-domiciling and to audit firms to obtain further comments in relation to practical issues from the accounting and auditing perspective.

<u>Taxation issues</u>

The CP (at paragraph 11) states:

Insofar as the Inland Revenue Ordinance (Cap. 112) is concerned, regardless of the domicile, profits tax is charged for a year of assessment if a person carries on a trade, profession or business in Hong Kong and has profits arising in or derived from Hong Kong from such trade, profession or business for that year of assessment. Any such profits tax liabilities are not affected by its re-domiciliation.

However the CP (also at paragraph 11) goes on to say:

Nevertheless, we will include necessary consequential amendments to the Inland Revenue Ordinance to provide certainty to the re-domiciled companies on their tax obligations, and to empower the Inland Revenue Department to address transitional tax matters such as fair deduction for trading stock, bad debts, impairment losses on financial assets, depreciation etc., as such elements that may have occurred before re-domiciliation would have to be taken into account for tax assessment after re-domiciliation.

While we agree with the opening statement that Re-dom as proposed, in and of itself, should not have any tax impact in relation to the Inland Revenue Ordinance ("IRO"), it is important that a re-domiciled company be treated as incorporated in Hong Kong from a tax perspective from the point of Re-dom onwards, as there are various references to place of incorporation in the IRO (for example where it considers tax residency). In this regard, we understand that the place of incorporation of a company cannot change, just like the place where a person was born and that, in practice, upon Re-dom, a company will be given a certificate of re-domiciliation in Hong Kong and

not a new certificate of incorporation. However, the proposal also talks about a re-domiciled company having the same rights and obligations as companies incorporated in Hong Kong and still being the same corporate entity, so this needs clarifying.

We suggest that, in general, caution should be exercised as regards making "consequential amendments" to the IRO. If the re-domiciled company is the same body corporate and legal person, there is no disposal, acquisition, commencement or cessation of any kind. The concern is that amendments may add complexity and uncertainty. A detailed review of the IRO should be performed before making any amendments to ensure that they are absolutely necessary. We note that, for example, in the case of open-ended fund companies, the tax-related Re-dom provisions were primarily limited to some clarifications of the effect of the re-domiciliation, in section 112ZJD (in particular section 112ZJD(4(b)) of the Securities and Futures Ordinance (Cap. 571).

While we would urge that changes to the current IRO be kept to a minimum, some changes are likely to be required in relation to the Global Anti-Base Erosion ("GloBE") Model Rules, which, in principle, the government is committed to adopting. As previously raised by TFEC members in meetings with the IRD, it is not clear whether a corporate taxpayer that is incorporated outside of Hong Kong but managed and controlled in Hong Kong would be considered as located in Hong Kong under the GloBE Rules. An entity is located where it is tax resident or, otherwise, where it was created. At present there is no general classification of a company as tax resident for the purposes of the IRO or profits tax (as opposed to definitions that apply for specific parts of the IRO, such as in relation to transfer pricing rules or funds exemptions). So a company that was formed under the laws of a foreign jurisdiction and re-domiciles to Hong Kong is likely to still be considered to be located in that foreign jurisdiction under the GloBE Rules, even if it is a taxpayer in Hong Kong and/or is considered resident here under Hong Kong's double taxation agreements (e.g., because its management and/or control is in Hong Kong), on the basis that the company was created in that foreign jurisdiction. This situation points to the need for a general definition in the IRO of a Hong Kong resident entity.

There is no mention of stamp duty in the proposals. We would assume that this is because it is clear that there is no transfer of chargeable items (e.g., Hong Kong stock or immovable property) that the foreign company owns as a result of Re-dom.

While, as noted above, changes to the IRO should be avoided, as far as possible, we would hope that the issuing of guidance and/or departmental interpretation and practice notes ("DIPN") will be considered, preferably at the time the Re-dom law becomes effective. In the case of court-free amalgamations, for example, guidance was not issued until a few years after the relevant law took effect and, ultimately, the guidance had the effect of reducing the attractiveness of the amalgamation regime.

In terms of areas to be covered in guidance and/or a DIPN, this may cover issues such as the following:

- Whether and, if so, how the proposed tax framework for Re-dom will cover foreign entities that have carried on a trade or business in Hong Kong (such as those already registered as non-Hong Kong companies under Part 16 of the Companies Ordinance (Cap. 622) ("CO")) prior to their Re-dom;

- whether tax credits will be given (upon approval) to a re-domiciled company if, for example, its originating jurisdiction imposes an exit tax on its unrealised profits and those profits are also taxed in Hong Kong;

- subject to whether a general definition of residence is introduced into the IRO, as proposed above, whether a re-domiciled entity will be recognised as a company incorporated in Hong Kong for purposes of the definition of tax residence in the IRO and double taxation agreements; and

- how the IRO will apply to various tax treatments upon Re-dom, e.g., valuation of inventory / fixed assets / transfer of employment, etc.

Separately, in the future, the government should also consider providing for an outward Re-dom regime, perhaps as a follow-up action, to provide greater flexibility for corporate restructuring.

<u>Solvency-related issues</u>

Regarding items (f) and (g) under paragraph 12 of the CP, it is not clear how it will be established that an application for Re-dom has been made in “good faith” and what other safeguards could be given to creditors. Further safeguards for creditors, by way of notification from the re-domiciled company, should be considered, such as:

- Written notice sent to each of its creditors at their last known postal and electronic address.
- Public notice placed in two news media in the company’s place of incorporation as well as its principal location(s) of business, in English and the local language.
- Both of the above to be done concurrently with the company giving 21 days’ notice of meeting to its members, if a meeting of members is required (i.e., a notice to creditors should be issued prior to, not after, Re-dom).
- The company to confirm to Hong Kong Companies Registry that it has done the above and has not received any major negative/ adverse feedback from its creditors.

In principle, the above steps could be done relatively easily without any additional, undue burden on the company, given that a company will presumably be required to notify its creditors of the Re-dom in any event; either because of contractual obligations or for business relationship purposes. If a company has difficulties in doing this, then questions may arise about the intentions behind the company’s application to re-domicile to Hong Kong.

We note from paragraph 16 of the CP that, after issuance of the certificate of re-domiciliation, the company concerned would be required to notify the Registrar of Companies (“R of C”) and provide evidence of de-registration in its original place of incorporation within 60 days (subject to any extension granted by R of C), in order to complete the process, failing which its company registration in Hong Kong would be revoked, meaning that the Re-dom process has not been successful and is therefore terminated.

However, under section 760 of the CO, a director or member of a company that has been struck off the register and dissolved can make an application to R of C for

restoration of the company to the register, up to 20 years after the date of dissolution. Under sections 756 and 766 of the CO, a range of persons can make an application to the court to have a company, which has been struck off the register and dissolved, restored to the register, up to 20 years after the date of dissolution. The effect of restoration in each case is that the company is to be regarded as having continued in existence as if it had not been dissolved and the court may give directions, and make orders, as seem just for placing the company and all other persons in the same position as nearly as may be as if the company had not been dissolved.

Other jurisdictions may have similar statutory provisions in their company or other laws. The possible implications are not immediately clear if a company that had been deregistered from its place of incorporation and re-domiciled to Hong Kong were to be restored to the register in its place of incorporation many years later. It could be assumed that a company that has re-domiciled elsewhere would not be treated as being dissolved in its original place of incorporation, but that is a legal matter that would need to be clarified. This may also be one reason why it would be preferable to consider applications from companies incorporated in jurisdictions that have an outward Re-dom regime as one would hope that the exit regime would have taken account of any such eventualities. However, all these issues need to be further explored and clarified.

Company law, accounting and auditing issues

The current Hong Kong company law restrictions on distributions by companies unless they have sufficient distributable profits are problematic. An increasing number of jurisdictions operate a solvency test approach instead of this, and inward Re-dom will be discouraged if there will be a subsequent limitation on the company's ability to pay dividends.

Even if they do re-domicile, it is not clear how they will apply the "distributable profits" test where they have not been tracking historic distributable profits or in respect of other capital and reserves under foreign law, such as share premium or contributed surplus. We would recommend that the Hong Kong company law requirements for distributions be brought in line with the capital reduction requirements – i.e., adopt a solvency test.

With regard to the Part 9 of the CO on accounts and audit, generally, a key issue seems to be that where a company that has been in existence for a while in a jurisdiction with no accounting requirements re-domiciles to Hong Kong, it could be very challenging for the company and the auditor to ascertain the completeness and accuracy of the balance sheet on the date of Re-dom.

Some more specific issues include the following:

- Opening balance audit: If the jurisdiction of incorporation does not require the company to perform a statutory audit on a yearly basis, or if the company prepared its audited financial statements using different generally accepted accounting principles ("GAAP") for the opening balances and comparative figures, how is the incoming auditor to audit the prior opening balances, review GAAP adjustments and provide assurance on the retained profit/ loss brought forward?

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- Change in statutory auditor: If the company has appointed an auditor before re-domiciling to Hong Kong, how is the incoming auditor to carry out professional clearance in relation to the prior auditor, as required by the Hong Kong Code of Ethics for Professional Accountants and auditing standards?

  If the company's prior auditor is not bound by a code of ethics and quality management standards equivalent/ similar to Hong Kong's, can the prior audited financial statements be taken to be reliable?

- Documentation retention: If the laws of the company's original place of incorporation do not allow any accounting records and books to be removed, how can the company provide evidence of its track record? Is the auditor in its place of incorporation required to perform audit procedures for the opening balances?

- GAAP transfer: A re-domiciled company, being a company subject to the CO, will be required to adopt Hong Kong Financial Reporting Standards ("HKFRS"), HKFRS-PE or SME-FRSs (HKFRS for public entities or HKFRS for small and medium-sized enterprises, respectively). The adoption of a new GAAP will likely involve additional professional fees and time, i.e., valuation and accountancy fees, which could discourage some companies from re-domiciling.

- Adoption of SME-FRS, reporting exemptions, etc.: There are a number of exemptions in the CO. Will there be any transitional arrangements for these exemptions, to smooth out the effect of this change, especially in relation to the two-year rule on adoption of SME-FRS (i.e., a company must meet size tests for two consecutive years in order to be eligible to adopt SME-FRS)?

Should you have any questions on this submission, please do not hesitate to contact me at peter@hkicpa.org.hk or on 2287 7084.

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Yours faithfully,

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