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Trends and Developments

Contributed by Vivien Teu & Co LLP

Vivien Teu & Co LLP is a Hong Kong law practice focusing on the areas of corporate, securities, asset management and financial services. The lawyers have in-depth Hong Kong and international legal practice experience, combined with deep and broad knowledge of China and regional markets. The firm advises on corporate and commercial law, and on securities law and financial regulatory matters in local and international transactions, and frequently handles corporate transactions and funds formation. It provides seamless support on cross-border Hong Kong and Mainland China matters in the areas of asset management, investment funds, cross-border securities and investments, inbound and outbound M&A, and China market entry strategies. The firm also offers dedicated trusts, succession and estate planning expertise, increasingly serving private clients and high net worth entrepreneurs in its wider financial services and wealth management practice.

Authors

Vivien Teu is the founding and managing partner of Vivien Teu & Co LLP, and has extensive, in-depth experience as a corporate and commercial lawyer specialising in the financial services sector, funds and wealth management. She has diverse legal practice experience with top-tier and magic circle firms in the areas of tax, trusts, banking and financial services, investment funds, securities regulatory and corporate commercial matters, and significant in-house counsel experience at a global investment firm. Vivien is noted for her extensive China knowledge.

Kenneth Yim focuses on tax advisory services and the tax-efficient structuring of cross-border corporate and commercial transactions for asset managers, investors and family offices in or involving Asia. His international tax planning experience includes tax issues in respect of start-ups, M&A, joint ventures, finance, intellectual property, real estate, insurance, estate planning, employment, and supply-chain management in a cross-border context. He also supports taxpayers in disputes with tax authorities and negotiations on advance tax rulings. Kenneth has particular experience in tax structuring with respect to Western and Asian inbound and outbound transactions, having practised as a tax lawyer in the Netherlands.

By way of background and broadly speaking, Hong Kong applies a territorial basis of taxation, whereby tax is imposed on assessable income arising in or derived from Hong Kong sources, or deemed as such. Tax is not levied on the basis of a person's nationality, domicile or residence. Under the so-called 'two-tiered' profits tax rates regime introduced in recent years, the tax rate for the first HKD2 million of (net) profits of incorporated or, respectively, unincorporated businesses is reduced by half (from 16.5% to 8.25%, or from 15% to 7.5%). The remainder of the profits continue to be taxed at the normal rate of 16.5% or 15%. Gains of capital nature (as opposed to revenue) are outside the charge of profits tax.

There is no specific tax on dividend income, and there is no withholding tax levied on dividends (or interest) paid to non-residents. As such, distributions from a Hong Kong company to shareholders, or to beneficiaries from a trust estate, out of income earned either in Hong Kong or outside Hong Kong are generally not taxable in Hong Kong or exposed to withholding tax leakage, regardless of whether they are resident in or outside Hong Kong. Furthermore, Hong Kong does not tax gifts, and estate duty was abolished in February 2006.

The relatively low tax rates and apparently friendly tax framework make Hong Kong an attractive location not only for income and wealth generation, but also as a centre through which wealth and assets are held and managed. Hong Kong is an international financial centre that has also established itself as a successful and prominent centre for asset management and financial services. It has also increasingly become a significant market in offering trust and wealth management services to high net worth and ultra-high net worth families in the region, including from Mainland China and other countries in Asia with emerging wealth.

Hong Kong Trusts

Hong Kong does not have specific charging provisions on income in respect of trusts. A trust has no separate legal personality and is not deemed a person subject to tax under the Inland Revenue Ordinance (IRO). However, the trustee of a trust estate is expressly defined as a taxable person in the IRO. In this connection, a person acting as trustee carrying on a trade, profession or business in Hong Kong would be subject to profits tax in Hong Kong in respect of the income in connection with that trade, profession or business, to the extent such profits are Hong Kong-sourced. Business and trading profits sourced in Hong Kong are chargeable to profits tax under the general charging provision of section 14 of the IRO if all of the following conditions are met:

- the person (including trustees) carries on a trade, profession or business in Hong Kong, whether as a principal or through a dependent or independent agent;
- the profits (other than capital gains in connection with the sale of shares) are derived from such trade, profession or business in Hong Kong; and
- the profits arise in or are derived from Hong Kong.

On the basis of the above, in practice, the general consensus is that trust profits in the hands of the relevant trustee fall within the charge to tax under the generic charging provision of section 14 of the IRO. Nonetheless, it is sometimes argued by trust and tax practitioners that the application of this general charging provision to trading trusts is quite opaque. As such, amendments to the IRO have been proposed to create specific provisions for the taxation of trusts (similar to the United Kingdom or Singapore), which may help in further developing Hong Kong's competitiveness as a trust jurisdiction.

Transfer of Hong Kong Assets

While there is no gifts tax or transfer tax in Hong Kong, assets settled into a trust would incur relevant stamp duty where it involves a transfer of shares in Hong Kong companies or Hong Kong real property from the settlor to the trustee generally, unless in circumstances where it can be established not to involve a transfer of beneficial interest. A gift would also be deemed to be a transfer for value and thus subject to stamp duty (except gifts made to charitable bodies or public trusts, which are exempt from tax under the IRO).

Stamp duty is chargeable on any instrument that transfers Hong Kong real property and shares. The transfer of shares in Hong Kong companies is chargeable to stamp duty at a total rate of 0.2% on the sale proceeds or the fair market value of the relevant shares, whichever is higher. Generally, the transfer of real property is charged at a progressive rate, with a maximum of 8.5% on the sale proceeds or the market value, whichever is higher.

To curb speculation in the Hong Kong real estate market, specific Ad Valorum Stamp Duty (AVD), Special Stamp Duty (SSD) and Buyer's Stamp Duty (BSD) have been put in place with respect to residential properties. As of 5 November 2016, a flat AVD rate of 15% applies (instead of the above-mentioned 4.25% to 8.5% range) to purchases of any residential property by non-Hong Kong Permanent Residents and/or if the purchaser already owns another residential property at the time of the subsequent purchase (irrespective of the amount or value of consideration, and irrespective of whether the purchaser is an individual or a company).

Where a transaction involves the sale and purchase or transfer of a residential property, the seller and the buyer are jointly and severally liable for paying SSD, which arises if (i) the property is acquired by the seller/transferor on or after 20 November 2010; and (ii) the property is disposed of by the seller/transferor within 24 months (if acquired between 20 November 2010 and 26 October 2012) or 36 months (if acquired on or after 27 October 2012) from the date of acquisition.

The buyer or transferee is liable to pay the BSD, which is generally payable on any agreement for sale or a conveyance on sale for the acquisition of any residential property executed on or after 27 October 2012, except where the purchaser or the transferee is a Hong Kong Permanent Resident acquiring the property on his/her own behalf (ie, the person is both the legal and beneficial owner).

Immigration

The Capital Investment Entrant Scheme (CEIS) has been suspended by the Hong Kong Government from 15 January 2015 until further notice. The CEIS was put in place to facilitate entry for residence in Hong Kong by persons making capital investment in Hong Kong of at least HKD10 million (the last investment threshold prior to the suspension of the scheme), and without a requirement for running a business in Hong Kong. Under the CEIS, permitted investments included shares of companies listed on the Hong Kong Stock Exchange and traded in Hong Kong dollars, debt securities denominated in Hong Kong dollars issued or fully guaranted by the Hong Kong Government, or by certain designated bodies (of a public nature), certificates of deposits in Hong Kong dollars issued by authorised banking institutions in Hong Kong, and certain approved eligible collective investment schemes.

As the CEIS is now not available, high net worth individuals may apply under the programme for investment as entrepreneurs, subject to meeting the requirements. This arrangement does not apply to Chinese residents of Mainland China, nor to nationals of Vietnam, Laos, Nepal, the Democratic People's Republic of Korea, Cuba or Afghanistan, although overseas Chinese nationals holding People's Republic of China passports may apply if they have permanent residence overseas, or have been residing overseas for at least one year immediately before the submission of the application. The criteria to be considered by Hong Kong immigration include whether the applicant is in a position to make a substantial contribution to the economy of the HKSAR, with consideration factors including, but not limited to, business plan, business turnover, financial resources, investment sum, number of jobs created locally and the introduction of new technology or skills. The Immigration Department will consider whether the capital investment amount is able to support the operation of the business.

An applicant who wishes to establish or join in a start-up business may be considered, especially if the start-up business concerned is supported by a government-backed programme with a rigorous vetting and selection process, and the applicant is the proprietor or partner of the start-up company or a key researcher of the relevant project. Examples of government-backed programmes include:

- StartmeupHK Venture Programme administered by InvestHK;
- Incu-App, Incu-Bio and Incu-Tech programmes administered by the Hong Kong Science and Technology Parks Corporation;
- Cyberport Incubation Programme;
- Small Entrepreneur Research Assistance Programme and Enterprise Support Scheme administered by the Innovation and Technology Commission; and
- Design Incubation Programme administered by the Hong Kong Design Centre.

Other programmes for residence visas in Hong Kong are the Admission Scheme for Mainland Talents and Professionals (available for Chinese residents of Mainland China who possess special skills, knowledge or experience of value to and not readily available in Hong Kong), and the Technology Talent Admission Scheme (during the three-year pilot scheme), other than general employment visa applications under the Hong Kong General Employment Policy.

Wealth Management and Family Offices

As an established financial centre and asset management centre, Hong Kong has significant breadth and depth in its financial markets infrastructure in terms of the availability of financial instruments, products and platforms, as well as the expertise and experience of finance and wealth management professionals. Where an institution engages in the conduct of regulated activities in securities and futures business in Hong Kong or actively markets to the public, whether by itself or through another person on its behalf and whether in Hong Kong or from a place outside Hong Kong, will need to be licensed by or registered with the Securities and Futures Commission (SFC) to conduct the relevant regulated activity, unless any relevant exemption applies. The conduct of regulated activities includes carrying on the business or provision of services dealing in securities or futures, advising on securities or futures, and asset management. Failure to be licensed or registered where required would constitute an offence under the SFO. There are no specific licence exemptions for family offices, although it may be possible to structure single family offices to fall under certain exemptions.

Trust companies may be set up in Hong Kong to conduct trust services business in Hong Kong, which means they may act as corporate trustee of as many trusts as they wish and charge remuneration for doing so, subject to being approved as a licensed trust and corporate services provider. There is no minimum capital requirement, but to become a registered trust company and to become eligible to act as a trustee for certain trust arrangements as prescribed under law or as corporate executor of a will, there is a minimum capital requirement of HKD3 million to be issued and fully paid up in cash, and HKD1.5 million must be deposited with the Government's Director of Accounting Services or a bank guarantee must be issued to the Government for the same amount.

A Task Force chaired by the Hong Kong Monetary Authority and comprising representatives from the Private Wealth Management Association (PWMA), the Hong Kong Institute of Bankers, the Hong Kong Securities and Investment Institute and the Treasury Markets Association has introduced an Enhanced Competency Framework (ECF), which sets out an enhanced level of competency expected of relevant practitioners in the private wealth management industry and offers professional qualifications as certified private wealth, investment or trust professionals. Although the ECF is a voluntary scheme, it underlies the efforts of the industry bodies in Hong Kong to further develop the competency and expertise of private wealth management professionals in Hong Kong, in particular those who offer banking, dealing, advisory or portfolio management services to private banking customers.

While the offers of securities (also futures and other financial products) are tightly regulated under the SFO, Hong Kong has a private placement framework that permits limited offers in Hong Kong and allows unlimited offers to be made to "Professional Investors" as defined under the SFO. Broadly, there are three main categories of Professional Investors: Institutional Professional Investors, such as financial institutions and specific bodies as prescribed in the legislation, and Individual Professional Investors or Corporate Professional Investors that meet the relevant minimum net worth or net assets requirements (being individuals with a portfolio of at least HKD8 million, or a corporation or partnership with a portfolio of at least HKD8 million or net assets of HKD40 million).

Onshore vs Offshore

Whether in the conduct of family-owned businesses or trust structures using offshore companies for the holding of investments or real properties, or for investment management, traditionally, it is common to use entities in jurisdictions with no tax or nominal tax, such as the British Virgin Islands or the Cayman Islands. However, from 1 January 2019, under the "Resumption of Application of Substantial Activities Factor to No or only Nominal Tax jurisdictions" issued by the Organisation for Economic Co-operation and Development (OECD), the introduction of economic substance requirements in such traditional no or nominal tax jurisdictions has raised concerns. It is usual that most of the entities established in the no or nominal tax jurisdiction that are performing relevant activities (such as investment holding, caught under the substance requirements) actually do not have real or adequate substance there. It would now be necessary to consider the requirements with respect to having local directors, managers, suitable employees, premises, operating expenditure, and income-generating activities undertaken in the relevant jurisdictions.

On the other hand, in practice, users of offshore entities are also looking to consider whether the substance requirements may fall away where a relevant entity carries on a relevant activity through another jurisdiction where it is subject to tax or is tax resident, and with an expectation that there may be more 'relocation' of activities or entities to an 'onshore' jurisdiction, such as Hong Kong, which has a friendly tax regime (but not with nil or nominal tax rates) and is not on the European Union's blacklist of non-co-operative jurisdictions.

It is recommended to conduct careful evaluation of the impact on affected entities, from assessing whether the economic substance requirements are applicable and can be satisfied, to assessing the feasibility of any possible options involving the conduct of activities or having entities in another jurisdiction. An entity that is established or relocated to Hong Kong may then, in principle, be subject to tax in Hong Kong on any income arising in or derived from Hong Kong sources under its territorial basis of taxation, and the potential tax implications that may arise should be considered.

Hong Kong Resident Entities

Generally, the Inland Revenue Department (IRD) may issue a 'Certificate of Resident Status' (ie, a tax residency certificate) to a company that is incorporated in a no or nominal tax jurisdiction if it can be proven to the IRD's satisfaction that the company in question is normally controlled and managed in Hong Kong. As such, the above-mentioned relevant entities incorporated in a no or nominal tax jurisdiction may become eligible for Hong Kong's network of agreements for the avoidance of double taxation (DTAs), subject to establishing its tax residency in Hong Kong. With that, similar to Hong Kong incorporated companies, entities incorporated in a no or nominal tax jurisdiction can potentially also enjoy tax treaty benefits (eg, reduced withholding tax rates with respect to the receipt of overseas dividends, interest and royalties, as well as protection against capital gains tax in the relevant investee country), provided that the relevant conditions are satisfied.

Hong Kong's Attitude Regarding Tax Transparency

As a responsible member of the international community and in order to maintain its international reputation and competitiveness as an international financial and business centre, Hong Kong has kept up efforts to adopt the latest global standards on tax transparency.

Since 10 July 2013, when the IRO was amended to enable the Commissioner of the Inland Revenue to conclude standalone tax information exchange agreements (TIEAs) with other jurisdictions, it is no longer necessary for a country to conclude a DTA with Hong Kong before it is able to submit an exchange of information request, as Hong Kong follows the OECD Model TIEA and, in terms of scope of the exchange of information, there is no difference in substance between a TIEA and the exchange of information article in double taxation agreements ("DTAs"). Accordingly, the Inland Revenue Department has expressed its view that, in terms of safeguards on the confidentiality of information exchanged and taxpayers' right of privacy, a TIEA and the exchange of information article (in a DTA) offer the same level of protection, since both the TIEA and the DTA are enacted as subsidiary legislation. On 25 March 2014, Hong Kong signed its first TIEA (notably with the United States). So far Hong Kong has concluded TIEAs with seven jurisdictions, and DTAs with 41 other jurisdictions.

Hong Kong has changed its attitude from providing information (only) upon request (based on TIEAs or DTAs) to the automatic exchange of information. Hong Kong has entered into a Model 2 intergovernmental agreement (IGA) in connection with the Foreign Account Tax Compliance Act (FATCA), under which financial institutions in Hong Kong are obliged to report information on their US clients and relevant transactions directly to the US Internal Revenue Service. The commitment to FATCA was one further step towards Hong Kong becoming compliant with the global initiative to exchange tax information on an automatic basis.

Furthermore, in 2016 Hong Kong adopted the new international standard for the automatic exchange of financial account information in tax matters – ie, the Common Reporting Standard (CRS) promulgated by the Organisation for Economic Cooperation and Development (OECD) – and in 2017 enabled its participation in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and also amended the IRO to implement the CRS.

Vivien Teu & Co LLP

17th Floor, No.29 Wyndham Street
Central
Hong Kong

Tel: +852 2969 5300
Fax: +852 2997 3385
Email: enquiry@vteu.co
Web: www.vteu.co

Ownership Transparency

On 1 March 2018, new law came into effect (ie, the Companies (Amendment) Ordinance 2018), requiring certain Hong Kong companies to collect and retain information about their beneficial owners, intended to enhance transparency related to corporate beneficial ownership and in accordance with recommendations published by the Financial Action Task Force (FATF). Essentially, it requires any incorporated company (except listed companies) in Hong Kong to identify people or entities that have significant control over the company (known as "significant controllers") and to maintain a register of significant controllers. Broadly speaking, a significant controller is either a person with significant control over a company or a registrable legal entity (such as another company) which is a shareholder of the company and has significant control over it – for example, a person who directly or indirectly holds more than 25% of a company's issued shares or is entitled to share in more than 25% of a company's capital or profits is deemed to have significant control.

Notwithstanding this, at present, there is no register for ultimate beneficial owners or trustees in Hong Kong, and the registers of significant controllers are not made available to the public. However, the online system of the Companies Registry (CR) allows the public to conduct searches (only) on data of registered companies and records of documents registered with the CR, including information on shareholders and directors of Hong Kong companies as filed with CR.

Following the recent Plenary of the FATF held in June 2019, the FATF has commended Hong Kong for its strong legal foundation and effective system for combating money laundering and terrorist financing following a mutual evaluation undertaken by member jurisdictions. Under the Mutual Evaluation Report of Hong Kong, the compliance and effectiveness of Hong Kong's anti-money laundering and counter-terrorist financing regime was assessed to be compliant and effective overall against international standards. This makes Hong Kong the first jurisdiction in the Asia-Pacific region to have achieved an overall compliant result. As noted in the press statement of the Hong Kong Government, the Report finds that Hong Kong has a strong legal and institutional framework for combating money laundering and the financing of terrorism, and is particularly effective in the areas of risk identification, law enforcement, asset recovery, counter-terrorist financing and international co-operation.