The Hong Kong Institute of Chartered Secretaries

Submission:

The Hong Kong Institute of Chartered Secretaries (HKICS)
Calls for a Redomiciliation Regime in Hong Kong

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By Email only

The Honourable Mr James Lau JP

Secretary for Financial Services and the Treasury

Financial Services and the Treasury Bureau

24/F, Central Government Offices

2 Tim Mei Avenue, Tamar

Hong Kong

Dear Mr Lau JP

The Hong Kong Institute of Chartered Secretaries (HKICS)

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About HKICS

The Hong Kong Institute of Chartered Secretaries (HKICS) is an independent professional institute representing Chartered Secretaries and Chartered Governance Professionals as governance professionals in Hong Kong and Mainland China with over 6,000 members and 3,200 students. HKICS originates from The Institute of Chartered Secretaries and Administrators (ICSA) in the United Kingdom with 9 divisions and over 30,000 members and 10,000 students internationally. HKICS is also a Founder Member of Corporate Secretaries International Association Limited (CSIA), an international organisation comprising 14 national member organisations to promote good governance globally.

Background[1]

- In recent years the European Union (EU) has taken action, through its Code of Conduct (Business Taxation) Group to identify non-cooperative jurisdictions based upon the criteria of tax transparency, fair taxation and compliance with the OECD's Base Erosion and Profit Shifting (BEPS) requirements[2].

[1] Gratitude is expressed to KPMG, PwC and Tricor Group for use of materials and information supplied in assisting in the preparation of this paper.

[2] https://home.kpmg/cn/en/home/insights/2019/01/china-tax-alert-06.html

- A number of tax neutral jurisdictions made commitments to reform their economic substance requirements by the end of 2018 to bring them into line with EU's 'fair taxation' principle that "a jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction", and avoid their inclusion in the EU's list of non-cooperative jurisdictions (EU Blacklist).

- Accordingly, in January 2019, a number of tax neutral jurisdictions, including the British Virgin Islands (BVI), Cayman Islands, Bermuda, Guernsey, Jersey and Isle of Man, enacted legislation requiring local entities carrying on specified activities in these countries to have adequate economic substance.

- The substance requirements took effect from 1 January 2019, with a six-month grace period given to existing entities to meet the requirements. Reviewing this new global standard will be a key part of the OECD's Forum on Harmful Tax Practices (FHTP) work plan for 2019.

- While each jurisdiction has independently drafted and enacted their own economic substance legislation, the requirements are broadly equivalent across each of the tax neutral jurisdictions. These changes also represent a response to recently established EU economic substance requirements, and a parallel new global OECD standard on substantial activities requirements for no or only nominal tax jurisdictions. The legislation is being reviewed by the EU and the OECD and may be subject to change.

- The rules, broadly, require both local and foreign companies and limited partnerships registered with a tax neutral jurisdiction which carry on a 'relevant activity' *and* are not tax resident in another jurisdiction (for example Hong Kong (HK)), to comply with the economic substance requirements for such activity in the tax neutral jurisdiction.

- Relevant activities for the purposes of this legislation cover the following nine businesses:
    a. Banking business
    b. Distribution and service centre business
    c. Financing and leasing business
    d. Fund management business
    e. Headquarters business
    f. Holding company business
    g. Insurance business

h. Intellectual property business
i. Shipping business

- The economic substance that needs to be established and maintained in respect of each relevant activity are:
    a. The entity is managed and directed in an appropriate manner in the tax neutral jurisdiction
    b. Core income generating activities are undertaken in the tax neutral jurisdiction with respect to the relevant activity
    c. The entity maintains adequate physical presence in the tax neutral jurisdiction
    d. There are adequate full-time employees in the tax neutral jurisdiction with appropriate qualifications, and
    e. There is adequate amount of operating expenditure incurred in the tax neutral jurisdiction in relation to the relevant activity.

- There are certain exceptions to these general economic substance requirements for pure equity holding companies (which will only be required to meet a reduced test for economic substance) and intellectual property companies (which will face more onerous requirements).

- Entities will have reporting obligations in relation to their compliance with economic substance requirements to local tax authorities. Penalties can be imposed both for a failure to provide required information and/or providing false or misleading information and for operating a legal entity in breach of the economic substance requirements, including fines, imprisonment and/or strike-off.

- In addition to the above, many jurisdictions look upon companies incorporated in tax neutral jurisdictions with suspicion, e.g. when evaluating inbound foreign investments by such companies or in scrutinizing the tax position of local entities that carry out transactions with such companies. Hence, there will be commercial considerations that may drive such entities to migrate to locations where they can align corporation registration with business substance.

The Opportunity

- Historically many HK individuals and businesses made use of entities in tax neutral locations for various purposes. While some might have a tax efficient purpose, in most cases this was more for

confidentiality, commercially flexibility and administrative cost minimisation – for example the use of BVI and/or Cayman Islands companies as listing vehicles, pure equity holding companies, or for businesses deriving income that would not be taxable under the Hong Kong Inland Revenue Ordinance (e.g. it was derived outside Hong Kong). In view of the tax transparency and economic substance requirements that are already in place, they would in all likelihood consider whether the traditional advantages necessarily continue to hold true. While some entities may attempt to fulfil the substance requirements with an outsourcing possibility which is permitted based on the current drafting of the laws, this is subject to the EU's endorsement, and many entities are seriously considering declaring themselves as tax residents of Hong Kong or another location where their operations are based, such that they can be exempted from fulfilling the substance requirements.

- At the moment however there is some uncertainty as to whether simply registering the tax neutral entities under Part 16 of the Companies Ordinance and Business Registration Ordinance would allow the tax neutral entities to have sufficient evidence to support their Hong Kong tax residency. In particular, some of the tax neutral jurisdictions may include a "subject to tax" requirement if an entity wishes to declare itself as tax resident outside the jurisdiction. The meaning of "subject to tax" is unclear. For example, a pure equity holding company that is registered in Hong Kong will need to file Hong Kong profits tax returns as and when issued by the Inland Revenue Department (IRD). However, oftentimes the return will be completed as a "nil" return because dividends and capital gains are generally not taxable in Hong Kong, and so the company will not have any taxable profits, and consequently will not actually pay any tax. It is unclear whether such type of entities could be accepted as being "subject to tax". Finally, in the event that the tax neutral jurisdictions insist on the provision of a tax resident certificate (TRC) issued by the IRD, this will be a challenge to many entities, since at the moment the IRD would only entertain a request for TRC for the purpose of claiming tax benefits under a double tax treaty that Hong Kong has concluded with another jurisdiction.

- Based on the above, it would seem that the way to achieve certainty under the existing regime is to transfer all the business and/or assets of the existing tax neutral entities to one or more Hong Kong entities. This could however give rise to potentially significant costs in certain cases, for example situations where the tax neutral entities hold investments (directly or indirectly) located in countries that impose tax on direct and indirect transfer of such investments.

- The above are the main choices currently available to such entities within Hong Kong corporate groups if they are not able to comply with the substance requirements in those tax neutral jurisdictions. This is because Hong Kong does not allow for redomiciliation of companies to or from Hong Kong. The concept of redomiciliation is that a company may "move" to a new jurisdiction by changing the jurisdiction under whose laws it is incorporated or registered. This is different from redomiciliation through a Scheme of Arrangement under the Companies Ordinance which involves the creation of a new company.

- Since jurisdictions such as the BVI and the Cayman Islands do allow redomiciliation under their companies laws, if the Hong Kong Companies Ordinance can also permit redomiciliation, this could provide Hong Kong individuals and businesses with an additional option, with more certainty, in dealing with the current challenge of the substance requirements. Once a tax neutral entity is redomiciled to Hong Kong, there would be no further compliance or reporting requirements in the tax neutral jurisdiction.

- The opportunities with a redomiciliation regime for Hong Kong are not limited to the potential redomiciling of tax neutral companies to Hong Kong. It potentially extends to companies intending to streamline their corporate structures to align with business substance in light of BEPS, or to take advantage of the various concessionary tax regimes that Hong Kong has recently implemented (e.g. corporate treasury centres, captive insurance, reinsurance, and aircraft leasing). In fact, many jurisdictions with established legal and tax governance regimes, such as Canada, Australia, Singapore and Luxembourg, have a redomiciliation regime to facilitate multinational businesses in conducting genuine business and/or commercial restructurings like cross-border mergers and acquisitions. Hence, introducing the redomiciliation regime will not only provide a neat solution in light of the recent changes in substance requirements, but may also facilitate multinational companies to relocate businesses to HK which can facilitate the growth of accounting, trust and corporate service provider (TCSP) services, legal and banking industries.

- The redomiciliation regime may also be complementary to the Greater Bay Area (GBA) initiative. This is because it is facilitative of targeted businesses to gain a foothold in the GBA area to add the economic vibrancy of GBA plan. Also, as a general proposition It may also well be attractive to multi-nationals to headquarter or establish part of its business for market access to China and the rest of Asia by taking advantage of Hong Kong's professionalism, Rule of Law, and the unique competitive advantage of permitting the use of both English and Chinese languages on registration and/or reporting purposes which are major factors for business considerations.

- As such, HKICS submits that Hong Kong should consider introducing redomiciliation regime. Ideally, Hong Kong should consider adopting rules that will allow both inward and outbound redomiciliation as this provides greater business flexibility for multinational companies seeking to set up operations in Hong Kong. At the very least, Hong Kong should consider adopting an inward redomiciliation regime (similar to Singapore which enacted its regime in 2017 but with comparatively lower qualifying thresholds in Hong Kong). An overview of the Singapore legal requirements is set out in Appendix A hereto. To complement this, the more critical piece perhaps is to ensure that appropriate tax legislation and/or guidance be introduced by the IRD in time to address the tax position of a business upon inward (and outbound, as the case may be) redomiciliation to reduce unnecessary tax uncertainty, e.g. tax cost base of different pre-existing assets (including expenditure on R&D, prescribed fixed assets, intellectual properties etc) that will be used, either partly or wholly, for carrying on business in Hong Kong, specific treatments where the change happens in the middle of a financial period, along with exit rules where applicable.

Should you have any questions, please feel free to contact Samantha Suen FCIS FCS(PE), Chief Executive, HKICS or Mohan Datwani FCIS FCS(PE), Senior Director, and Head of Technical and Research, HKICS at 2881 6177 or research@hkics.org.hk.

Yours faithfully,

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Appendix A

The Companies (Amendment) Act 2017 has introduced an inward re-domiciliation regime in Singapore, to allow foreign corporate entities to transfer their registration to Singapore (e.g. foreign corporate entities that may want to relocate their regional and worldwide headquarters to Singapore and still retain their corporate history and branding). The regime took effect from 11 October 2017[3].

A foreign corporate entity that re-domiciles to Singapore will become a Singapore company and be required to comply with the Companies Act like any other Singapore incorporated company. Re-domiciliation will not affect the obligations, liabilities, properties or rights of the foreign corporate entities.

Requirements

The minimum requirements for transfer of registration are:

a. Size criteria – The foreign corporate entity must meet any 2 of the below:

   i. the value of the foreign corporate entity's total assets exceeds S$10 million;

   ii. the annual revenue of the foreign corporate entity exceeds S$10 million;

   iii. the foreign corporate entity has more than 50 employees;

b. Solvency criteria:

   i. there is no ground on which the foreign corporate entity could be found to be unable to pay its debts;

   ii. the foreign corporate entity is able to pay its debts as they fall due during the period of 12 months after the date of the application for transfer of registration;

   iii. the foreign corporate entity is able to pay its debts in full within the period of 12 months after the date of winding up (if it intends to wind up within 12 months after applying for transfer of registration);

   iv. the value of the foreign corporate entity's assets is not less than the value of its liabilities (including contingent liabilities)

c. The foreign corporate entity is authorised to transfer its incorporation under the law of its place of incorporation;

d. The foreign corporate entity has complied with the requirements of the law of its place of incorporation in relation to the transfer of its incorporation;

e. The application for transfer of registration is —

   i. not intended to defraud existing creditors of the foreign corporate entity; and

   ii. made in good faith; and

[3] For application forms and further details, please refer to: https://www.acra.gov.sg/legislation/legislative-reform/companies-act-reform/companies-amendment-act-2017/inward-re-domiciliation-regime-in-singapore

f. as at the date of the application, the foreign corporate entity's first financial year end at its place of incorporation has passed;

g. There are other minimum requirements such as the foreign corporate entity is not under judicial management, not in liquidation or being wound up etc.