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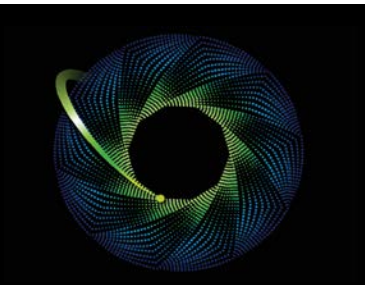

Hong Kong Tax Newsflash

Draft legislation of company re-domiciliation regime introduced

Hong Kong | Tax & Business Advisory | 30 December 2024 | Issue 235

The Bill[1], which seeks to implement an inward company re-domiciliation regime in Hong Kong, has been published in the Hong Kong Government Gazette on 20 December 2024. It is expected to be introduced into the Legislative Council for first reading in early January.

Framework

The company re-domiciliation regime contained in the Bill provides a simple and cost-efficient procedure for non-Hong Kong incorporated companies to re-domicile to Hong Kong. Following re-domiciliation to Hong Kong under this regime, re-domiciled companies will generally have the same rights as a locally incorporated company.

A substantial portion of the Bill is comprised of amendments to the Companies Ordinance and its subsidiary legislation, including addition of new sections to provide for requirements for re-domiciliation, application procedures and reporting obligations, as well as changes throughout the ordinance so that existing provisions applicable to a Hong Kong-incorporated company now also apply to a re-domiciled company.

The Bill also amends, among other ordinances, the Inland Revenue Ordinance so as to address transitional tax matters and tax treatment for re-domiciled companies, as well as the Insurance Ordinance and the Banking Ordinance, so that entities re-domiciled into Hong Kong will be treated under the insurance and banking regulatory regimes as if they were incorporated in Hong Kong and so that assessment requirements are in place with respect to re-domiciliation applications by these regulated entities.

Who are eligible

The original place of incorporation of the applicant company must permit outward re-domiciliation. For reference, the current legislative frameworks of British Virgin Islands (BVI), Cayman Islands, Bermuda and certain European jurisdictions permit outward re-domiciliation of their locally incorporated companies, subject to the respective local specific conditions.

Specifically, under the proposed regime, non-Hong Kong-incorporated companies may only re-domicile in Hong Kong as (i) private companies limited by shares; (ii) public companies limited by shares, (iii) private unlimited companies with a share capital; or (iv) public unlimited companies with a share capital.

[1] Companies (Amendment) (No. 2) Bill 2024

Other requirements include, among others, that the company must have at least ended its first financial year, that re-domiciliation is not made for unlawful purposes or for defrauding creditors, that shareholders' consent is obtained, and that the company can pay its debts in full within the next 12 months.

What are the benefits

In recent years, under the international backdrop of ever-rising compliance, economic substance, reporting and disclosure requirements in common offshore jurisdictions such as BVI, Cayman Islands, Bermuda, etc., the maintenance of offshore companies is getting not only time-consuming and costly, but also increasingly challenging. Hence, there has been an observable need for taxpayers to relocate their companies historically incorporated in offshore jurisdictions to another location where these companies can be practically managed and controlled out from (such as Hong Kong). Taking the common example of a BVI incorporated company which is principally engaged in investment holding and the associated activities of acquiring, financing, holding, administering and disposing of its underlying investments. At present, such an arrangement is subject to challenges from multiple angles and how the company can stay fully compliant while maintaining its offshore status is questionable.

In the absence of the proposed re-domiciliation regime, relocation of a non-Hong Kong-incorporated company to Hong Kong would have to be achieved by various more complicated, indirect and costly methods. This can include court-sanctioned schemes of arrangement, or having the shareholder establish a new Hong Kong-incorporated company and transferring the business over to this new entity from the existing non-Hong Kong incorporated company. Alternatively, in the past, the most common approach taken by taxpayers was to merely register their offshore companies in Hong Kong as non-Hong Kong companies pursuant to Part 16 of the Companies Ordinance, whereby such companies would inevitably be subject to compliance requirements and costs in both jurisdictions. Such dual-jurisdiction status is often not considered to be a long-term sustainable solution for an efficient organizational structure.

In contrast to these more convoluted pathways, the new inward re-domiciliation regime provides a predictable, straight-forward and likely less expensive alternative for a business to relocate to Hong Kong. It also enables a non-Hong Kong-incorporated company to maintain its legal identity after re-domiciliation in Hong Kong and ensures continuity as there is no need for transfer of assets, property and contracts.

How to apply

Applications are to be made to the Companies Registry. Key documents required include an application form setting out company particulars, as well as constitutional documents and its certificate of incorporation. Importantly, if neither the law of the original domicile nor the constitutional documents of the applicant requires shareholders' consent for re-domiciliation, the amended Companies Ordinance will require that shareholders' approval by at least 75% of eligible shareholders be obtained. The applicant also has to submit a legal opinion from the original domicile of the company stating, among other things, that the proposed re-domiciliation is legally permitted in the original domicile. Recent financial accounts and director's certification as to solvency of the company are also needed.

A successfully re-domiciled company will be registered with the Companies Registry and will be issued a certificate of re-domiciliation. If the company had been a registered non-Hong Kong company with the Companies Registry, such registration will then cease to have effect.

It is worth noting that within 120 days after re-domiciliation, the Companies Registry must be provided with evidence of the re-domiciled company's deregistration from its original domicile. Failure to do so will result in revocation of Hong Kong registration, termination of the re-domiciliation process and reversion to a non-Hong Kong-incorporated company.

What are the tax implications

Hong Kong tax legislation has its longstanding territorial basis which does not impose tax on the basis of residence or domicile. Under section 14 of the Inland Revenue Ordinance (IRO), any persons, including corporations, partnerships, trustees and bodies of persons, carrying on any trade, profession or business in Hong Kong are chargeable to tax on all profits (excluding profits arising from the sale of capital assets) arising in or derived from Hong Kong from such trade, profession or business.

By such virtue, if a non-Hong Kong incorporated company has never carried on any trade, profession or business in Hong Kong before it re-domiciles to Hong Kong, no profits tax will be charged on the company for the period before it commences business in Hong Kong. On the contrary, if a non-Hong Kong incorporated company has carried on a trade, profession or business in Hong Kong before it re-domiciles to Hong Kong and has profits chargeable to tax from such trade, profession or business before its re-domiciliation, it will have profits tax liabilities from such profits. Re-domiciliation will not relieve the company from its profits tax liabilities in respect of the pre-domiciliation period, and vice versa.

With the above in mind, the current draft legislative amendments to the IRO are not applicable to the situation where a re-domiciled company has carried on the same trade, profession or business in Hong Kong before and after re-domiciliation. They are only applicable to the situation where a re-domiciled company has carried on a trade, profession or business outside Hong Kong before re-domiciliation and commences to carry on the same or another trade, profession or business in Hong Kong after re-domiciliation. The main aspects covered by the legislative amendments to the IRO are summarized as follows:

- Hong Kong tax resident: General interpretation provisions under Section 2 of the IRO have been added to the effect that references therein to a company "incorporated in Hong Kong" include a re-domiciled company and references to a company "incorporated outside Hong Kong" exclude a re-domiciled company. This would mean that, under the comprehensive avoidance of double taxation agreements or arrangements (CDTA) signed between the Hong Kong Special Administrative Region (HKSAR) and other jurisdictions where a resident of the HKSAR is defined for the purpose of the CDTA to mean, among others, a company incorporated in the HKSAR, a re-domiciled company would also be regarded as a resident of the HKSAR.

- Transitional tax arrangements for Hong Kong Profits Tax purposes with regards to expenditures incurred by a re-domiciled company which has not carried on a Hong Kong business before will be put in place for elimination of double taxation:

    - Pre-re-domiciliation expenses would be allowable for tax deductions under the general rules provided that they were incurred in the production of assessable profits and no tax deductions have already been allowed in or outside Hong Kong before.

    - Cost base of trading stock acquired before re-domiciliation and used in a business carried on in Hong Kong afterward would be taken as the lower of its acquisition cost or its net realizable value on the re-domiciliation date.

    - Intellectual properties (IP) registration fee and building refurbishment costs on IP registration or building refurbishment done before re-domiciliation for non-Hong Kong business but used for Hong Kong business afterward, would be treated as incurred in the basis period of the year of assessment in which they will be first used for Hong Kong business.

- Research & Development (R&D) expenditure incurred before re-domiciliation for non-Hong Kong business but related to Hong Kong business afterward would be treated as incurred in the basis period of the year of assessment in which the R&D will first become related to the Hong Kong business.

- Capital expenditure on purchase of IP, prescribed fixed assets and environmental protection facilities, if used for Hong Kong business after re-domiciliation, would be treated as incurred in the basis period of the year of assessment in which such assets will be of first Hong Kong business use, and valuation would be based on the lower of historical cost minus accumulated amortization and impairment losses or market value upon re-domiciliation.

- Capital expenditure on plant and machinery, if used for Hong Kong business after re-domiciliation, would be treated as incurred in the basis period of the year of assessment in which such assets will be of first Hong Kong business use, and valuation would be based on the lower of historical cost minus notional allowances or market value upon re-domiciliation, with specific calculations for plant and machinery acquired under a hire purchase agreement.

- Specific tax treatments for re-domiciled insurers are also addressed in the Bill.

- Unilateral tax credits will be available in the re-domiciliation year or any subsequent year of assessment where a re-domiciled company has paid tax in its place of incorporation in respect of its unrealized profit because of company re-domiciliation, and Hong Kong Profits Tax is also payable on the same profit after re-domiciliation.

In addition, there are also other aspects about re-domiciled company that are not covered in the Bill but should be considered in conjunction.

- Stamp Duty implications: While there is no amendment proposed to the Stamp Duty Ordinance, this implies that no Hong Kong stamp duty liabilities will arise from the re-domiciliation process itself. However, Hong Kong stamp duty may arise for subsequent transfer of the shares of the re-domiciled company as such transfer will be required to be registered in Hong Kong.

- Annual audit requirement: A re-domiciled company has to comply with annual audit requirements under the Companies Ordinance, among other compliance obligations.

- Amalgamation with another Hong Kong company would now become possible for a re-domiciled company, and so it will provide the needed flexibility to multinational groups for their future structure reorganization.

Our observations

Given that many jurisdictions with which Hong Kong shares close economic ties already permit re-domiciliation, we welcome Hong Kong's introduction of its own re-domiciliation regime. In particular, many common offshore jurisdictions that make up a significant number of registered non-Hong Kong companies, (such as the BVI, among others) permit outward re-domiciliation. Based on market intelligence, we expect there to be sizeable interest from both the Hong Kong and global business communities to re-domicile offshore group entities to Hong Kong, for reasons including tax certainty and potential compliance savings, among others. Of course, the decision to re-domicile should align with strategic plans as to where such entity will carry on its business and where it will be managed and controlled out from.

From a tax perspective, the proposed amendments to IRO have largely addressed various transitional tax issues which may arise on company re-domiciliation with a view to provide certainty on re-domiciled companies' tax positions and eliminate any possibility of double taxation. The proposed allowance of Hong Kong Profits Tax deductions for expenditure on assets acquired and general expenses incurred pre-re-domiciliation are welcomed by taxpayers. On the other hand, although only the lower of the cost or net realizable value on the re-domiciliation date will be allowed for Hong Kong tax deduction on trading stocks, a unilateral tax credit mechanism has been properly introduced at the same time, which would effectively help to resolve double taxation potentially suffered in jurisdictions both with or without CDTA with Hong Kong. On the same date of the gazette, the Inland Revenue Department (IRD) has also published guidance on its website specifically on company re-domiciliation regime's associated tax implications. Therein, a number of illustrative examples have been provided on various scenarios of re-domiciled companies engaging in investment holding and securities trading in showing how potential double taxation under different situations could be effectively eliminated.

Referring to the example of the BVI incorporated investment holding company above, it would appear that by re-domiciling to Hong Kong, the entity could be better placed on its tax and compliance position going forwards in terms of economic substance compliance management, tax residency status and proof, Hong Kong Profits Tax position (including Foreign Sourced Income Exemption certainty, eligibility of potential tax benefits and tax exemptions under the IRO), Pillar Two reporting considerations, future group restructuring flexibility, etc. All in all, under the current international tax landscape, Hong Kong re-domiciliation regime seems to be one of the few long-term and sustainable solutions for existing offshore structures. It is also worth noting that all the aforementioned proposed IRO amendments catering to re-domiciled companies are not equally available for foreign companies registered in Hong Kong under mere Companies Ordinance Part 16 registration.

In our discussion with clients on the proposed re-domiciliation regime in the past months, our gathered feedbacks show that tax neutrality and tax certainty are of primary importance in deciding whether or not to redomicile offshore companies to Hong Kong. We are happy to see that the proposed legislative amendments have quite thoroughly and clearly addressed the public's concerns. We are also confident that the proposed Bill can extend the friendliness of Hong Kong's tax regime to offshore companies and encourage their re-domiciliation to Hong Kong in the near future.

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