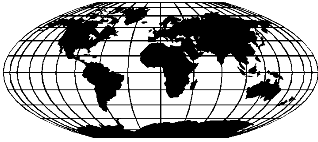
EAST ASIA TRANSNATIONAL

INTERNATIONAL COMMERCIAL LAWYERS



HONG KONG AND AUCKLAND, NZ

NEWSLETTER

(HONG KONG EDITION)

JULY 2000 ISSUE NO 7

IN THIS ISSUE:

1 New securities Legislation

3 New Trademarks Bill

3 Tax - Use of Offshore Companies

4 Internet - Effect of the New Electronics Contract Bill

5 MPF and ORSO

5 Tax Havens Under Attack

5 Trusts- Personal Financial Planning

(1.) SECURITIES LAW

(A) Securities and Futures Commission Bill

Much has been written about the new Securities and Futures Bill(SFB), which was Gazetted for public discussion and debate in April. We do not propose to comment in detail on the radical and wholesale changes to the licensing system and the law that the SFB contemplates, but for the benefit of our clients we propose to try and highlight the more important amendments proposed.

Clients involved in any aspect of securities dealing will have to keep abreast of the progress of the SFB because if passed in its present form it will require some securities dealers to undertake radical restructuring and re-licensing. For instance, it is contemplated that only companies will be licensed in the future and not individuals and partnerships, and those in the latter category will have to change to a corporate structure within two years. In addition, what was effectively a safety net for those promoting investments although themselves unlicensed, (known as the " professionals exemption" where marketing was direct to a registered dealer) is under major revision.

1 Regulatory Objectives

To achieve its stated aims of protecting investors and ensuring that markets are fair and transparent, the SFC proposes introduction of radical investigative powers allowing it to:

(a) require production of records and statements concerning listed corporations pursuant to clause 135 of the SFB
(b) force auditors to release documentation where the SFC believes on reasonable grounds that relevant documents are held by the auditor
(c) require bankers to similarly produce documents regarding a company under enquiry
(d) obtain information from any party who has dealt with the corporation in question
(e) intervene in the business operations of dealers under investigation, and to prohibit certain dealings or require the transfer of property to the SFC

2 Securities and Futures Appeals Tribunal

So as not to allow the SFC to act with impunity or in a capricious manner, there will be new Tribunal where decisions made by the SFC can be questioned and adjudicated upon in a judicial manner.

Principal: Timothy J Brears LLB (NZ)
A solicitor of the High Courts of Hong Kong and New Zealand

Auckland Office
36 Penguin Drive, Murrays Bay
Auckland 1310
Tel: (09) 476 4471
Facsimile: (09) 476 4473
E-Mail: transnet@voyager.co.nz

Hong Kong:
Suite 1501 &1503
Chinachem Tower
34-37 Connaught Road
Central Hong Kong

3 New licensing system- abolition of intermediaries

The most radical change in the SFB is to abolish the concept of intermediaries (the "professional" exemption where non-dealers dealt through a registered dealer, and analogous categories, such as exempt dealers) and to impose a single license system. This, and allied amendments, can be summarised as follows:

(f) exempt status to Authorised Institutions only
(g) clarification of the SFC attitude to lawyers and accountants who give advice incidental to their business - apparently it is thought that this conduct should come under regulation, and that is has been abused in the past
(h) continuation of exempt status for persons who deal solely with professionals, but subject to reporting and Code of Conduct requirements
(i) issue of a single license to investment intermediaries, with conditions attached as to the scope of business
(j) re-definition of what activities will require a license
(k) one-off authority from the SFC to allow a body to perform a specific function
(l) a requirement that all those persons, including all directors, who have influence over management and supervision of a dealer be licensed and designated as responsible officers and who must satisfy additional licensing criteria. This would include compliance officers etc.
(m) only corporations to be licensed
(n) provisions to the effect that contact with unlicensed operators are voidable at the option of the client
(o) powers to insist that only those " back room" assistants who have proper qualifications will be allowed to work for a dealer, and as well, there will be a requirement of continuous training.
(p) the single license system will mean that a company will be licenced as a single license entity, but with designated conditions attached to it summarising which areas of business the Company may operate in
(q) greatly increased penalties for defaults or misconduct, including power to levy a fine of HK$10,000,000.00 or three times the loss or gain as a result of misconduct.

4 Other New Changes

(a) a company will be set up to provide a compensation fund for investors
(b) a proposal to change the disclosure level of interests in listed companies from 10% to 5%, with the period of disclosure cut down to 3 days
(c) A radical new right of action to investors who suffer loss as a result of an announcement by a person which is false or misleading and influences, or may influence, the price of securities. The aggrieved investor is able to take a civil action against the person making the announcement
(d) The setting up of a Market Misconduct Tribunal allowing civil and criminal sanctions against insider trading, and market manipulation
(e) There will be legislative recognition of on-line trading and part 111 of the SFB allows for the setting up of automated trading systems.

5 Consequential and New Amendments to the Protection of Investors Ordinance (PIO)

Consideration has also been given to certain issues concerning marketing of investments which have hitherto been dealt with under the Securities Ordinance (SO) and the PIO.

(1) The power of the Financial Secretary under section 2A of the PIO to specify what are and are not "investment arrangements" has been limited to real estate, and doubts have existed as to whether it covers security related products the return from which is derived by fluctuations in value of underlying securities. It is proposed that under the SFB a new investment category be created covering all investment arrangements.
(2) Doubts or whether the SFC had power to withdraw authorization of products will be dealt with under amendments to the SO and PIO.
(3) A wider range of products under section 15 of the SO will be able to be authorized, and not simply unit trusts and mutual funds.

COMMENT: While many of the proposals in the SFB are to be welcomed, and bring Hong Kong into line with other jurisdictions, some amendments are ambitious and frankly unworkable. In particular, we doubt that it will be possible to bring in legislation imposing civil liability on those who make false or misleading statements to the market as a whole, which seems to create a kind of class action suit, and would impose a considerable burden of proof on a litigant wishing to prove direct loss from the statement. In addition, such legislation may well act as dampener on those responsible from making any sort of prediction, no matter how well based, on the proposed plans of a group or company, which would not be in the interests of the investing public at large.

(B) Other Securities Legislation to note

Briefly we would mention other legislation either in committee stages or nearing a second reading in the Legislative Council:

(i) the Securities (Amendment) Ordinance - this deals with short selling orders though the Stock Exchange, and requires that a person proposing to sell short must provide to a dealer an assurance that he has access to the requisite securities, and the dealer selling as principal must have in his possession necessary written confirmation from counter-parties.

(ii) The Securities (Margin Financing) (Amendment) Bill seeks to prevent unlicensed companies carrying on securities margin trading, especially as those types of companies were victims of the Asian financial crisis which hit Hong Kong. In brief, a company must be licensed as a securities margin trader with the SFC, accounting statements must be given to the client end of next business day, and a client's securities may be deposited with a bank or financial institution, or sold, in order to provide financial accommodation only with the written consent of the client in a specified form, which has a time limit. There are also rights to rescind a contract with an unlicensed dealer.

COMMENT: While the proposals to regulate margin trading are long overdue, we doubt that the legislation will prevent further losses, simply because it is still open to a company, even if licensed, to access funds from trades it makes for a client, and to deal with securities it holds in a fraudulent manner. The real issue is the solvency of the dealer to make restitution in the case of individual fraud on the part of one its dealers, and this issue does not appear to be addressed. If margin trading is to be done, we recommend it be done through a licensed bank, and not through a private company with limited resources.

(2.) INTELLECTUAL PROPERTY

New Trademarks Bill

Due to come into effect later this year the new Trademarks Ordinance (TO) is notable for a number of changes to the existing Ordinance:

1 Well known Trademarks

A result of the TO appears to be that registered marks which are categorised as "well known" will qualify for more protection than those that are less famous.

This follows from section 14 which, in addition to providing that an infringement is committed if someone uses a sign which is (i) identical to the trademark in relation to goods and services which are (a) identical for which it is registered, or (b) similar to those which is registered; or (ii) similar to the trademark in relation to goods and services which are identical or similar to those for which it is registered; or (iii) identical or similar to the trademark in relation to goods and services which are **not identical or similar to those which is registered; the trademark has a reputation in Hong Kong and the use takes unfair advantage of and is detrimental to the character of or repute of the mark**

2 Definition of well known trademarks

This is not defined in the TO, but would include such factors as the degree of recognition of the mark, the duration of registration, the geographical area of protection of the mark... and record of any successful protections.

COMMENT: For owners of marks seeking the ultimate protection it is clear that widespread recognition and geographical registration would be necessary before the very wide ranging protection afforded by section 14 was available for well known marks.

3 Parallel importing of Goods

The Government's intention seems to be to legalise parallel imports where the goods are authentic and the same mark is used in a group, irrespective of the fact that the trademark owner in Hong Kong may have imposed restrictions on an overseas manufacturer or licensee and forbidden them from distributing outside the country of origin. It is only where the goods have been altered and where the trademark will be detrimental that imports will be held to be illegal.

4 China - position of a famous mark

China has never apparently recognised a famous mark, but there is provision under its Trademark Law to do so. There is no restriction on parallel imports into China, and it is normal for owners of products who appoint distributors in China to register their marks and then register user contracts between themselves and the local licensed distributor.

(3.) TAX ISSUES

(A) Tax Havens under Attack

In 1989 Britain and other "western nations" established the Financial Action Task Force (FATF) based on the Organisation of Economic Development and Cooperation in Paris to combat money laundering and required most tax havens to pass legislation setting up checking procedures to deter offshore banks and individuals being knowingly, or unwittingly, involved in such activities. This action is seen to be fair and reasonable, save that

with pressure from the USA and Europe Britain has had to extend the scope of FATF to cover "fiscal offences" (breach of its and other nations tax laws) which may be committed through utilisation of such jurisdictions as BVI, Caymans, Bahamas, Cook Islands etc. And the OECD has on the 25/5/2000 produced a list of countries which it says are known tax havens, and which it says are distorting the financial system on a large scale. While it was probably thought that "fiscal offences" was not intended to be lumped in with money laundering, it now appears clear that the OECD expects that tax havens will in the future have to co-operate with the tax authorities of various OECD countries to track down known tax evaders. In addition, "fiscal offences" are meant to be treated as crimes by all tax haven countries.

While some tax havens may refuse to co-operate, the sanctions that can be indirectly applied by the international banking sector alone are a powerful incentive to conform, as otherwise banks, under pressure from Governmental authorities, will simply refuse to send funds there.

The effects of the FATF are far reaching and it will now be advisable to study in detail how confidentiality will be affected in each country. For instance, Bermuda, regarded as a well behaved tax haven, requires disclosure of all beneficial owners of Companies, while BVI will now require that the names of Directors appear on a public register. It seems however that Directors can still be nominees, and no disclosure of the real directors is required.

As an illustration of how determined the OECD is over the whole issue, the Bahamas, considered a mainstream financial centre, is classed as "non co-operative" on one list of the OECD, and eight other countries top all three OECD lists, including St Kitts-Nevis, and Niue, Nauru and the Cook Islands. Jersey, Guernsey and the Isle of Man are also on the list in the category of tax havens. The USA is also considering sanctions against a country, a bank or even a type of transaction where a tax haven is involved.

COMMENT: While the issues are serious for clients owning/controlling tax haven entities, and require careful monitoring, we do not expect that there will be anything to fear if IBC's and other tax haven entities are used for trusts, asset protection, or simply as useful tools in structuring within legitimate group activity.

(B) Tax advantages of using a tax haven Company in Hong Kong

We need not consider the traditional advantages of using tax haven companies in the well known fields of re-invoicing, etc., which are too well known to repeat.

What may be less well known are the considerable incentives that may be available by using some of the less well known jurisdictions that have recently been developing their legal and tax systems, and who also benefit from the provisions of the European Directive 90/435 which provides for no withholding tax on dividends from member states so long as the parent company itself not exempt from taxation in its own jurisdiction. Accordingly, a Hong Kong Company having a subsidiary in Germany would face a 25% withholding tax on dividends remitted to Hong Kong, whereas if the shares in the German subsidiary were owned by a Company in Madeira (which can take advantage of the EU directive mentioned) then the dividend tax would be eliminated.

Another example would be Mauritius, which has a advantageous double tax treaty with the PRC allowing a permanent establishment to exist for as long as 12 months before tax residency is assumed, and generous tax credits for investments in coastal regions of the PRC. In addition, capital gains in China earnt by a Hong Kong Company would be subject to a 20% local tax, whereas under the Mauritius/PRC tax treaty such gains are mitigated.

(C) Tax exempt Trust in New Zealand

Although not generally known, but increasingly being used, New Zealand offers complete exemption from tax or the filing of tax returns where a non-resident settlor establishes a Trust with New Zealand based Trustees. There is no tax on the Trust investments outside New Zealand, so long as the Settlor remains a non-tax resident.

(4.) ELECTRONICS TRANSACTIONS ORDINANCE

The Electronics Transactions Ordinance (ETO) came into effect on the 7/1/2000 and was mentioned in a previous Newsletter. It has been the subject of a number of articles already, and we will not repeat what has been said already. Rather we detail certain basic rules that ISP providers and those using the Internet should be aware of when contemplating a transaction or advertising on the Internet.

(1) Subject to certain exceptions such as wills, trusts etc., contracts can now be formed via the Internet using electronic records as evidence.

That being so, we advise clients who may be negotiating or simply corresponding with third parties to consider placing a template or footer on the E–Mail to the effect that the correspondence is subject to contract and execution of a formal written contract under seal - the short words "Subject to Contract" may be enough, but might be insufficient if in other respects there appeared to be an intention to create legal relations. Care is needed lest a contract is formed in certain situations.

(2) Those persons having advertisements and invitations on their Web Sites should exercise care in wording lest it is possible for a buyer to accept what is offered electronically, and establish an immediate contract which might not be what the owner of the Site wishes. As an example, an advertisement that promised a free holiday to the first 100 persons who registered for a programme or who purchased goods would be an offer which could accepted by anyone. By contrast, if by mistake an offer was made stating a price at US$10.00 instead of US$100.00 and the invitation was deemed to be an offer, then it might be very difficult for the owner of the Site to avoid the resulting contracts made, unless it could be established that it was an offer to treat only.

(3) Complex legal issues may still arise as to when and if a contract has been formed, and section 19 of the ETO has not clarified the situation completely.

The basic rule is that a contract is formed when an electronic record has been accepted by a "designated information system". But the failure to "designate" or nominate a system means that receipt occurs when the electronic record comes to the knowledge of the addressee.

COMMENT: All these statutory definitions seek to cover a situation left unclear by the old postal contract rules, and in our view, it would make sense to place in a footer a statement to the effect that for the purposes of E-Mail and all other communications the designated information system is the E-Mail address together with the physical address notified in the E-Mail message. However, it depends whether clients wish to have contracts formed by E-Mail. While on some occasions this will be desirable (where sales are made from a Web Site) in other complex commercial transactions, we think there are risks involved, and expressions that negotiations are subject to contract are advisable. The main point to remember is that no longer can communications in cyberspace be treated as inconsequential; they now have legal consequences.

(5.) ISSUES EFFECTING ORSO AND MPF PARTICIPATION

Many employers will doubtless be looking at the possibility of cutting contributions to Orso schemes, where the Employees do not have to make a contribution, by setting up a scheme under the MPF where only a 5% contribution has to be made by the Employer. This decision must be made by the 1/12/2000.

Various obstacles exist to changing schemes, and may be summarised as follows;

(1) Reductions in Orso contributions under the Trust Deed may be a breach of the Deed.

(2) Unless there is a right for the Employer to do so, reduction might also be a breach of the employment contract with the Employee.

(3) Transfer of the Employees to an MPF scheme may (and most probably would) require the consent of all employees who are members of the scheme, if accrued benefits are to be affected.

(4) Termination of the Orso scheme by winding up may be an option, but in that instance, a pay out would be required. To avoid that, amendment by consent of the existing Trust Deed and Rules may be necessary.

COMMENT: Most Employers will be aware of some of the issues outlined above, but resolution of them before the 1/12/2000 may not be easy. Staff who will not co-operate will create problems, and early attention to potential problems is advisable.

(6.) TRUSTS AND ASSET PROTECTION PLANNING

We are heavily engaged in the establishment of offshore Trusts for family succession, asset protection, tax planning, estate duty planning, and preparation of wills.

We have a range of short information notes on most of these topics, as well as sample wills which we recommend for certain businessmen.

Many clients may form a trust but forget a will, which is still required to deal with assets outside the Trust, particularly any Trust debt due to the Settlor who sets up the Trust, and such assets as insurance policies etc.

For further information on our fees and services in this area, please contact us. Our costs are 60% cheaper than comparable Hong Kong charge out rates.

Disclaimer:

The content of this Newsletter is for general information only, and may not be relied on by any party without specific written advice from our firm. Parties acting without written advice do so at their own risk, and no responsibility is accepted by this firm for any consequences that may result.

EAST ASIA TRANSNATIONAL

July 2000