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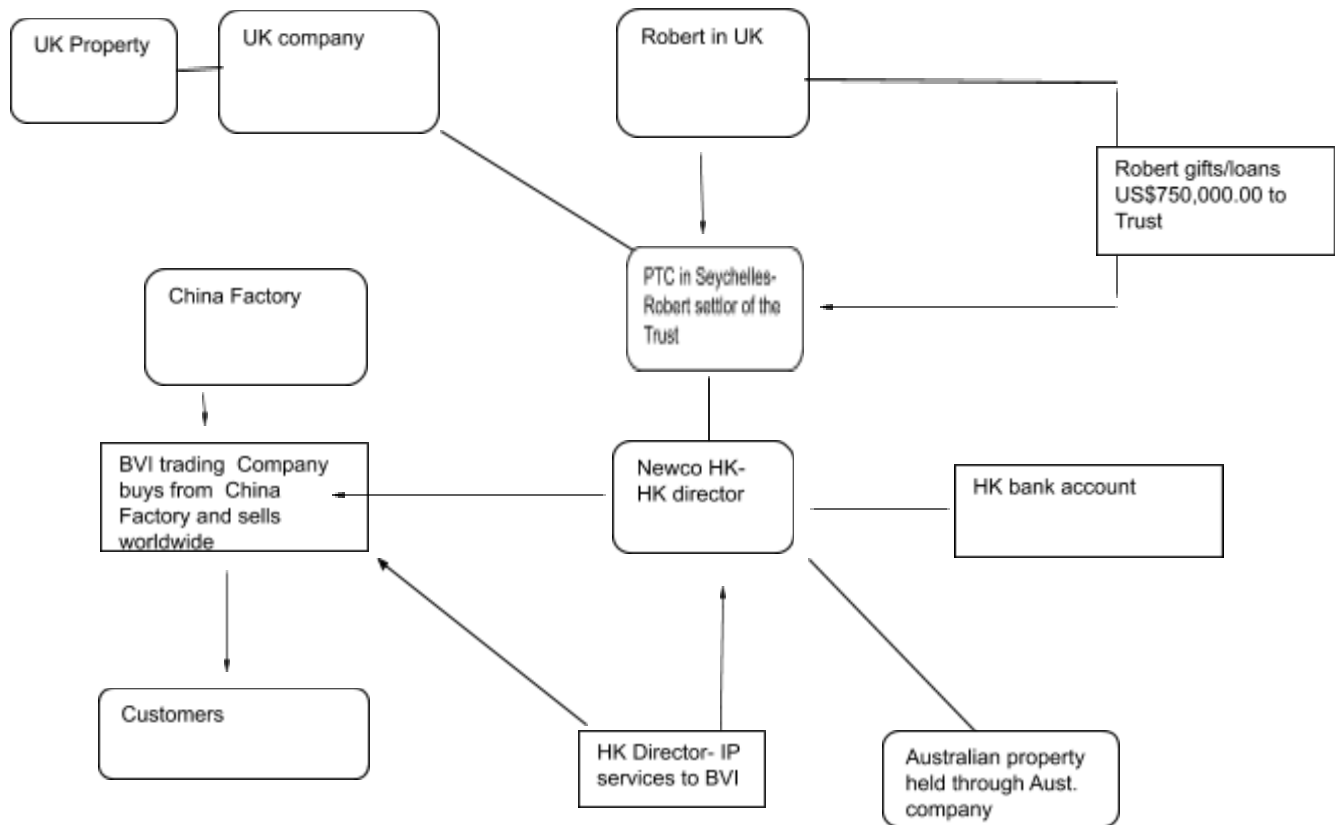
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1. CROSS BORDER INVESTMENT USING HONG KONG

1.1 Hong Kong has always been seen as an ideal jurisdiction for an international investor in view of its tax and legal system. Hong Kong's advantages are well known and there is no need to repeat them here. However, with the moves by Governments around the world (particularly the Financial Act Task Force) to try and identify tax evasion and illegal funds Hong Kong and most other OECD countries have been forced to make a number of amendments to their tax codes a Company Legislation. These amendments, combined with capital gains and inheritances tax in some countries, means that cross border investment and trading using Hong Kong now comes with more difficult and expensive compliance costs. In addition, the increased compliance costs and loss of confidentiality arising from the changes may mean investors and traders will be forced to consider whether traditional Hong Kong structures for new investment and trading structures, or existing ones, need to be considered or reviewed.

1.2 The current difficulties can perhaps be seen more clearly by studying the following example. This is an example only for discussion purpose and is not intended to show a proper or professional structure:

- (a) Robert is an investor based in the UK.
- (b) He carries on an international business and also wishes to set up an offshore trust to protect his assets. He employs a HK based director who is expert in designing toys and other gifts items manufactured in a China factory. A BVI company sells product ex China;
- (c) He sets up the following structure:



As a result of this structure Robert and his advisors have to consider a number of difficult issues as below.

1.3 Anti -Money Laundering Legislation(AML) in HK and Seychelles

(b) Most countries now have AML. This runs from mild to moderate measures (say Hong Kong and Seychelles) to the extreme (New Zealand). In the above example, the entity providing services to the Trust (if based in HK or the Seychelles) will be required to not only gather certified copies of Robert’s passport and address proof but due to the size of the amount of money involved may well have to enquire as the source of the funds. If an entity, whether a law firm, Trust company or service provider, does not obtain satisfactory evidence, it cannot lawfully act for the investor or client. HK AML now requires licensing of legal firms, Service Providers and Trustee companies as part of the AML process. When the funds hit the HK bank account it is open to the bank in its source of wealth investigations to also seek documentary proof of the source of wealth in an extra due diligence enquiry. In a recent case in New

Zealand it has taken 4 months of work to provide documentary proof of the source of wealth of Hong Kong and Chinese investors, including translation of chinese commercial agreements and share option agreements to provide the bona fide origins of the funds to set up a NZ company. The time and costs and the delays in opening a bank account can be enormous. Legal firms, Trustees and Service Providers are now having to charge for the AML services which adds considerable costs to the transaction. As has been said in an English case, service providers are a guardian, not a bloodhound. Governments should take note;

- (b) It should also be noted that if a client uses a BVI or other offshore company in a transaction the bank concerned may well be obliged under AML legislation to carry out extra due diligence in relation to funds involved and in many instances we have seen that a bank will simply not open a bank account for an offshore company or for a company in which the beneficial owner is a BVI or other offshore company.

1.4 Beneficial Owners Register:

- (a) The Trustee and the director of Newco HK will, under changes to the HK Companies Ordinance, be required to identify a natural person (“ a Registrable Person”) or “ Specified Entity” who has significant control over the company;
- (b) If over 25% of the share capital is owned by the same person or entity, the Company will have to identify that person on a significant controllers register (SCR) kept at the registered office of the Company. It will be an issue if Robert as settlor of the Trust can exercise control over the Company and whether he needs to be named as a person who controls the Company. The local HK director and/or the secretary may need to look into the documentation to see if Robert in some way has control of the Company, whether as settlor, protector or in some other way. This is not always a simple exercise and if the HK Director suspects someone is the real controller, he may give a notice to the person he suspects to be the controller;
- (c) Although the SCR is not open to the public it can be accessed by the IRD in a tax investigation either in HK or from an overseas tax authority using co- operation treaties with HK and CRS to track down Robert if there a default in his UK tax obligations;
- (d) There is little doubt the Companies Office in Hong Kong is enforcing the requirement to have an SCR. On 7 January 2019, the Companies Registry announced that twelve Hong Kong companies were prosecuted for,

among other things, failing to keep an SCR at their registered offices, and the companies were fined;

- (e) It should be noted that Robert's company in the UK may have similar beneficial owner disclosure obligations under UK legislation;
- (f) Hong Kong companies have in the past been regarded as safe and confidential entities where nominees were often used to keep ownership confidential. Now, that has changed and while we do not condone tax evasion or money laundering, there are some situations where persons innocent of tax evasion and use of illegal funds may with good reason wish to have ownership of a company kept completely confidential. That is no longer the case.

1.5 Common Reporting Standards (CRS)

- (a) The application of CRS will now be well known to all and we do not propose to go into more detail here. Suffice to say that most clients will have received self- certification forms from banks seeking to identify whether the person or entity named as the account holder has a tax presence in another country and/or who the controlling owners of the account are.
- (b) The Director of the HK company in which Robert's Trust holds the shares will be sent a CRS form by the HK bank and will need to consider a number of issues before completing the form and returning it to the bank. CRS legislation draws a distinction between an active non- financial entity and a passive one. The entity is an active entity if more than 50% of the entity's gross income consisted of active income and less than 50% of the **assets** held by the entity was used to produce **passive income**. Clearly the financial situation of Newco HK will need to be examined and its overall assets and derivation of income from trading and property investment assessed. If, as seems likely, Newco HK is a passive entity then Director of Newco will have to report to the HK IRD (who then report to the UK tax authorities) the names and UK IRD nos. of the controlling persons of Newco HK which will include Robert, protectors, beneficiaries etc.
- (c) Robert has nowhere to hide and his liability to UK tax on the Trust's income and his personal liability to UK tax will need to be considered.

1.6 BEPS and Transfer Pricing in Hong Kong

- (a) On the 13/7/18 the Inland Revenue (Amendment) (No. 6) Ordinance 2018 came into force. This legislation (based on the Base Erosion and Profit

Sharing (BEPS) principles enacted by the OECD) is mainly concerned with setting up a new transfer pricing regime in Hong Kong;

- (b) In keeping with OECD principles the focus now of transfer pricing is not so much on legal persons, such as companies, individuals etc. but on enterprises and is thus concerned with economic reality. The legislation therefore brings in a framework to govern pricing between associated enterprises;
- (c) The new regime covers a number of areas, such as defining a PE, carving out domestic exceptions, etc but what is of interest to Robert and Newco HK is the value of IP and designs rendered to the BVI trading company from Newco HK. Under section 15 of the Ordinance a value to the design and IP extended to the BVI trading company and accruing to it may be taxable in Hong Kong;
- (d) Any fees that are not at arms- length paid to the BVI Company for say marketing services would also be denied a tax deduction to Newco HK and although this has been the case for some time under existing law now the situation is codified and beyond doubt;
- (e) The new regime will mean that Robert and other investors and traders seeking to use HK as a jurisdiction for a holding or trading company will need to take professional advice on a suitable structure and review any existing structures in light of BEPS principles. Licensing arrangements over Intellectual Property are particularly vulnerable.

1.7 The Australian Capital Gains and Withholding Taxes:

- (a) Robert decides to sell the Australian property for A\$850,000.00 after holding it for two years;
- (b) His Australian company held through the Trust will need to pay full capital gains tax on the profits as the 50% discount for property held for over 12 months is no longer available;
- (c) In addition, Robert, as a non- resident or his Trust/Company, may face a withholding tax of 12.5% imposed on contracts entered into after 1/7/17. The purchaser is required to withhold that tax.

1.8 The UK Capital Gains Tax:

- (a) Robert may also wish to sell the UK property for a capital gain;

(b) However, our understanding is that as from 6/4/2019 UK proposes to tax capital gains by non – residents in relation to property held directly or indirectly. It is an issue whether Robert as a resident of UK is exempt as well as his UK Company and/or Trust;

(c) Robert's Trust may also have reporting obligations to the HMRC;

1.9 Summary:

(a) Cross Border investment is now far more complex and a step into the unknown without proper professional advice. Beps may have an impact on the structure;

(b) Compliance and possible taxation costs in many countries are now much higher and need to be considered before adopting any structure;

(c) While Hong Kong on the whole still offers considerable advantages as the place for a holding company from a costs and confidentiality perspective it is not as attractive as it once was and other jurisdictions may offer possibilities. We are attaching a summary of costs, tax rates and other important information relating to companies in HK, BVI, UK, Australia and New Zealand. It is in our view possible, with advantage, and in certain circumstances, to hold assets through jurisdictions other than Hong Kong which may be cheaper and offer the same tax advantages.

2. Management of a Family Group Business:

2.1 In Hong Kong and other parts of Asia large family business's are commonly run by family members with the founder and father very often controlling most decisions and having majority control of an entity or control of a Trust that may own the majority of shares in the holding company of the Group;

2.2 Family companies usually grow out of an entrepreneurial idea, many of them husband and wife partnerships initially. In Hong Kong fortunes in real estate and trading enterprises have been made by families;

2.3 the owner is usually the manager and financial backer;

2.4 employees are known personally;

2.5 As the business grows the owners have to decide whether they want other people involved. Sometimes children or spouses might be brought in to grow the company. Children are better educated than their parents. If a family business is faced with rapid expansion, or the founder is near retirement age, there can be much uncertainty about what lies ahead and many new

challenges which the family may not be equipped to deal with. In some cases the founder is middle aged and may have young children in which case different planning for the future may be appropriate.

2.6 Taking the next step:

- (b) professional expertise can help shift entrenched thinking and take the business to a new level. A formal board structure, with children or the trustees of their trusts holding shares in a family holding company and with one or more independent directors, can provide the outside perspective and objectivity that is needed;
- (b) bloodline descendants only- there may be a need in some families to limit the possibly of outsiders coming in as shareholders on a transfer of shares or death of a child. Restriction on transfer of shares may be built into the constitution of the family company.

2.7 The establishment and dynamics of a family board of Directors

- (a) When a formal board is established:
 - (i) everyone's role needs to be identified and defined so as to avoid the risk of family members feeling disengaged;
 - (ii) the needs of individuals, within a family board, also need to be balanced
 - (iii) some family members may want to be involved and grow the company but others, such as daughter, may not;
 - (iv) some might want to stick with the status quo;
 - (v) the board can also help to overcome disputes within family groups.

2.8 Independent directors and families

- (a) A board with one or more independent directors can transform a loosely run family company into one that's operating smoothly. It can make sure the company has:
 - (i) a strong senior management team;
 - (ii) strong HR, leadership and governance structures;
 - (iii) well-defined and achievable company goals.

However, independent directors must be co – operate with senior family members otherwise the board will not function.

2.9 Relationship risks

- (a) There is also a significant risk of a family business being dominated by relationship issues. These human factors might include:
 - (i) poor communication and bad behaviour
 - (ii) simmering tensions and resentment
 - (iii) dominating personalities
 - (iv) the founder or owner always having the final say
 - (v) complications arising from marriages and blended families.
- (b) The objectives of the founder for the business are critical. If an owner is more interested in selling the business or passing it on to another family member, then setting up a board can be equally important to ensure that the business is left in good hands.

2.10 Advantages and disadvantages of a family business

- (a) A majority of business's in Asia are family owned. Many family businesses have advantages that give them the winning edge over their competitors:
 - (i) adaptability, ingenuity and passion, strong relationships with employees, suppliers and customers;
 - (ii) the ability to retain corporate or specialist knowledge within the company;
 - (iii) At the same time, a family business can have distinct disadvantages. They can suffer from:
 - (iv) being too closely involved with day-to-day matters to deal with bigger issues in a business-like way;
 - (v) insufficient accountability;
 - (vi) reluctance to change in order to comply with health and safety, environmental and employment requirements;
 - (vii) a lack of strategic skills needed to plan for the future, or navigate a rough patch;
 - (viii) a lack of agility and flexibility to make decisions quickly;
 - (ix) conflicting views about company goals or the need for change.

2.11 Suitable Structures for a Family Business

- (a) a structure that suits one family group may not suit another. All the issues raised above need to be considered in order to come up with a suitable family structure;

- (b) The most common situation is where the founder and his wife are aged and have young well educated children who wish to participate long term in the business. The founder owns the majority of shares in a holding company which owns the underlying operating subsidiaries;
- (c) The best approach is for the holding company to be re- structured or a new one formed. The following are some issues that can be covered:
 - (a) The existing holding company becomes the family management company(FMC”)
 - (b) If dividends are to be up streamed from the subsidiaries the FMC should be in Hong Kong or a suitable offshore jurisdiction so that dividends can be distributed tax free, assuming the shareholders reside in Hong Kong. Other tax planning may be needed;
 - (c) The Founder, his wife and the children should all hold shares in the FMC;
 - (d) A comprehensive shareholders agreement or family charter, which can cover such issues as bloodline descendants, rights to transfer shares, buy out rights if a shareholder wishes to retire or simply go his or her own way, remuneration etc. can be signed between all family members. These provisions need to be mirrored and embedded in the Articles or Constitution of the FMC;
 - (e) Voting rights can be covered. As an example, on major issues, it may be the founder may have, through weighted voting rights, a final say on major and strategic business decisions but otherwise decisions will be by majority vote;
 - (f) Transfer to or succession by bloodline descendants can be covered on the shareholders agreement and FMC constitution or Articles of Association;
 - (g) The Founder may well hold his shares in the FMC through a trust. Planning over what happens to the Trust if the Founder dies, the future wellbeing of the widow, and what happens to the shares of the Founder on death are all complex issues that need to be discussed. An issue sometimes is whether the Trustee remains a professional trustee or whether a PTC (private trust company) is more flexible;
 - (h) The Founder needs to review his personal affairs, update his will and review his Trust, if he has one.

2.12 **Summary:**

- (a) Reviewing an existing family structure is seldom easy and may ignite family quarrels:

(b) However, for the Founder it is an exercise that should be done lest on death the position is unclear and there is no FMC with a functioning board. It is in the interests of the whole family that there be a well planned FMC in place.

3. Wills:

- (a) Every person should have a will. Aside from the obvious issue that a person wants to make sure his wife and children are bequeathed certain assets, passing away intestate (without a will) will be very costly and delay administration of an estate;
- (b) You can set up long term Trusts under a will and do not need to do it in your lifetime. As an example, a minor can be left shares in a family company which he does not receive until he reaches say 30 years of age, and the Trustees of the will can be given authority to establish such a Trust. The Trust operates from the date of death unlike an inter vivos trust that is established during a persons' lifetime;
- (c) Separate wills should be made for any jurisdiction where assets are situated;
- (d) We prepare simple wills for HK\$4000.00 to HK\$5000.00. We will quote for more complex wills.

4. New Zealand Foreign Trusts- the position since amending NZ Government legislation following the Panama Papers:

- (a) Following the Panama Papers leak in 2016 the New Zealand Government, in a “knee jerk” reaction, moved to change the law so that these supposedly sinister vehicles (Trusts with a NZ based Trustee and a non -resident Settlor- termed “ Foreign Trusts”) were required to register with the NZ IRD. The Trustee had to name settlors and beneficiaries (with their local TIN (tax number) and file annual accounts and annual returns. In addition, all distributions from the Trust needed to be reported with names and TIN nos. of beneficiaries;
- (b) Prior to the amendments in the law New Zealand had been the most popular offshore Trust jurisdiction due to its respectability and well established Trust law supported by well qualified and experienced Trust practitioners;
- (c) It is interesting to note that while the settlors of many Foreign Trusts chose to move from NZ many trusts did not and we have continued to provide Trustee services to many of them;

- (d) With the advent of CRS, BEPS, new AML laws, one has to ask if having a foreign Trust in NZ is as bad as the compliance requirements in (a) above would seem to indicate. As an example, a Trust, established say in the Seychelles or Hong Kong, with a bank account in Hong Kong or any CRS country, under CRS, must now report the Settlor, Protector and beneficiaries, together with TIN nos, to their countries of residence (via HK IRD) where they are tax resident. A Trustee, if acting properly in terms of most Trust Deeds and under Trustee law, must also prepare annual accounts and have financial records. That is no different from NZ. The register in NZ is private and only accessed by the IRD and regulators. Granted, where a settlor and beneficiaries live in Hong Kong, there is no danger in a report under CRS as Hong Kong does not tax Trusts or distributions from them. However, settlors and beneficiaries not living in Hong Kong and living in a CRS country will have no such protection if there is a bank account in Hong Kong;
- (e) Accordingly, we would not automatically dismiss NZ as a place to establish an offshore Trust. While it has legal requirements now that may, on the face of it, appear more onerous than a Trust based in some offshore jurisdictions, it is arguable that a well run and well administered Trust in any jurisdiction should do most of things that a Foreign Trust based in NZ should do;
- (f) AML legislation may also be an issue. A NZ based foreign Trust may be held in better light if it wished to open a bank account in Hong Kong than one based in an offshore jurisdiction;
- (g) BEPS legislation may also have an impact on a Trust that pays no tax in a any jurisdiction under “ reverse hybrid” legislation- that is a situation where a Trust is transparent under local law but “ opaque “ under the law of the Settlor. This is a complex area but it is clear the days where a Trust, or a Company, based in certain jurisdictions, earns income, but pays tax nowhere, are over.

EAST ASIA TRANSNATIONAL

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