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I. Reform of Trust Law in Hong Kong:

- 1.1 The Reform Process:** Most professional trustees and service providers who offer services in the trust area will be aware that the HK Government conducted a public consultation process on the proposed revision to the Trustee Ordinance (“ Ordinance”) in 2009. In March 2012 detailed amendments were announced which will be placed before the Legco in the 2012/13 session;
- 1.2 Dated Ordinance:** There is little doubt that that the Ordinance, based on the English Trustee Act of 1925, is very dated and out of touch with modern commercial law and practice. As an example, no power exists in the current Ordinance for trustees to vest securities in nominees;
- 1.3 Disappointing Proposals:** In general, we think the proposals disappointing. While dealing with some obvious anomalies and one or two contentious areas, such as the scope of exemption for Trustee negligence or wrongdoing, there was no attempt to put forward proposals to at least match all of those in Singapore and little attempt to make HK a favoured centre for Trust activity in Asia, although statutory recognition of reserved powers to settlors is a positive move. Amendments that could have been made to the Ordinance include provision for Protectors, specific recognition of PTC’s, and amendments to the licensed trust regime more in line with Singapore’s system. In addition, the contentious area of the right of beneficiaries to information was not dealt with and it seems the law as established by the UK case of Schmidt V Rosewood (2003) 3 ALL ER 76 will continue to apply. And amendments to the Inland Revenue Ordinance to make it much clearer that a HK Trustee does not face tax on income not earned in HK as the beneficial owner of such income would have been welcomed;
- 1.4 Ordinance Provisions Subject to Contrary Intention in the Deed of Trust:** While there will there may be a need to Trust Companies to review the wording of their standard Trust deeds in light of the proposed amendments (which we deal with below) there is no cause for panic. The amendments do not impose a completely new regime or make radical alterations to the existing Ordinance. It should also be realized that whatever the provisions in the Ordinance they will not take effect if a contrary intention is expressed in the Deed of Trust. The wording in the Ordinance is as follows: “ The powers conferred by this Ordinance on trustees are in addition to the powers conferred by the instrument, if any, creating the trust, but those powers, unless otherwise stated, apply if and so far only as a contrary intention is not expressed in the instrument, if any, creating the trust, and have effect subject to the terms of that instrument”. We have assumed that the ability to modify

the provisions in the Ordinance will continue to apply, although it should be noted, as mentioned below, that some amendments may be entrenched unless specifically made subject to exclusion as is the case with some duties mentioned below.

1.5 Major legislative Amendments Proposed:

The major amendments proposed are as follows:

- (a) Exempting the Trustee from liability: Clauses in Trust Deeds that exempt the Trustee from liability in the event of mistakes or negligence are invariably included in Trust Deeds and have received the sanction of the Courts (or at least the more reasonable ones). The better clauses do not exclude liability for fraud or gross negligence. The Government proposes to outlaw any clauses that absolve a professional Trustee from fraud, recklessness or misconduct and prevent indemnification from Trust assets. Issues that come to mind over this change are who is a professional trustee (licensed ?), the high burden of proof (“ recklessness may be hard to prove) and whether a contrary intention in the Trust Deed may still absolve a Trustee, or whether it will be a statutory entrenched requirement. A grace period of one year will be allowed to allow Trustees to make the appropriate changes to documentation, if indeed the proposed amendment will be a entrenched requirement in the Ordinance.
- (b) Statutory Duty of Care: The Government proposes to impose a statutory duty of care on Trustees. It is proposed that a trustee should exercise such care and skill as is reasonable in the circumstances, having regard in particular, to any special knowledge or experience that the trustee has or holds out as having, and if the trustee is acting in the course of a business or profession, to any special knowledge or experience, it is reasonable to expect of a person acting in the course of that kind or business or profession. This new statutory duty of care will apply regardless of whether the trust was created before or after the coming into force of the proposed new legislation, but will not affect the legality or validity of anything the trustee has done before that. The legislation will specify which matters to which the duty of care applies, such as investment, appointing agents etc. It should be noted that this duty of care may be excluded from the trust deed.
- (c) Power to employ nominees, custodians, agents and statutory safeguards

English case law requires the trustee to maintain personal control over the trust property. The Ordinance allows trustees to deposit bearer securities with a banker, but there is no power to vest trust assets in nominees. This is an impossible situation when investment managers commonly manage

their clients' investment portfolios on a discretionary basis without the need to register shares in the names of the client. The Government proposes to make amendments to the Ordinance to allow the Trustee to vest trust property in name of the Trustee. However, to avoid the appointment of unsatisfactory nominees safeguards will be those adopted in Singapore, which are as follows:

- (a) the application of the statutory duty of care to the employment of agents, nominees and custodians;
- (b) a stipulation that trustees give their agent a statement as to how assets are to be managed (policy statement) and the agent must agree to comply with the policy statement;
- (c) a restriction that only businesses who act as nominees or custodians, or a company controlled by the trustees may be so appointed (this would exclude the appointment of individuals who are 'amateurs' rather than professionals from this work); and
- (d) trustees are obliged to review from time to time the arrangements relating to their agents, nominees and custodians.

A Trustee will not be liable for the default of an agent if it has discharged its duty of care as noted in the above safeguards.

(d) Reserved Powers to Settlor

One of the most useful amendments proposed to the Ordinance is to follow the Singapore model and provide that a trust will not be invalid by reason of the settlor reserving to himself powers of investment or management functions. This may increase the attractiveness of Hong Kong as a trust jurisdiction, although such powers reserved to the Settlor were already quite common. It will not affect the power of the court to consider the validity of such a trust and the scope of the powers reserved will need to be carefully considered. We prefer the settlor be a Protector in cases where the Settlor may become based in a high tax jurisdiction where reserved powers may prejudice the integrity of an offshore trust. The amendments will provide that where a trustee acts in accordance with the directions of a settlor, where powers are reserved, the trustee will be exempted from liability. This is a significant advantage for Trustees.

Trustees of existing and new trusts will need to consider what policy and procedures they wish to adopt over the above amendments proposed. Each Trust is different and there is no guarantee that changes can be made to documentation or procedures in a completely uniform way.

1.6 Other proposed amendments- matters requiring review in existing Trust Deeds.

We propose to mention briefly other proposed amendments of somewhat lesser importance and highlight issues that might arise in relation to existing and new trust deeds and the need for review and possible amendment by trustees.

- (a) Beneficiaries' right to remove a Trustee:- a limited statutory right is to be added in relation to retirement and appointment. Existing trust needs need to be reviewed;
- (b) Charging by Trustees:- if no charging clause in the Trust deed, there will be limitations on charging if there is a sole trustee. We suggest trustees make absolutely sure there is an appropriate charging clause;
- (c) Power to insure: Existing provisions in the Ordinance limit insurance to indemnity fire insurance. The Trustee has no power to take out replacement insurance or cover other risks. The amendments propose that the a Trustee may insure against any risk and pay premiums from trust income. Well prepared Trust deeds will almost certainly (or should) contain wider powers of insurance than those in the Ordinance. We suggest powers to insure in the Trust Deed should be reviewed;
- (d) Power to appoint Agents: Section 25 of the Ordinance covers powers to appoint agents in and outside Hong Kong. It is proposed to widen the powers considerably and have one wide set of powers to cover the delegation of trust powers both inside and outside Hong Kong. These powers follow similar legislation in Singapore and UK. The effect of the new powers will be that trustees will be able to appoint agents to carry out any of their functions except distribution, the decision whether a payment should be made out of income or capital, the appointment of a new trustee and sub-delegation or the appointment by the agent of nominees or custodians. For charity trustees, it is proposed that agents be limited to the generation of income to advance the charity's objects but not carrying out those objects. It should also be noted that there are restriction on the appointment of agents and in particular, a beneficiary (even if that beneficiary is a co-trustee), may not be appointed as an agent of the trustees. In our view trustees of HK trusts will need to modify the provisions in existing trust deeds, or, if Settlers or beneficiaries do not want such powers, exclude them, assuming they are not entrenched provisions;
- (e) Power to delegate: Section 27 of the Trustee Ordinance permits a trustee to delegate his/ her functions to an attorney for up to one year, but the

attorney may not be the trustee's only co-trustee, except for a trust corporation. To protect beneficiaries, the Government will amend Section 27 so that if a trust has more than one trustee, delegation should not leave the trust having only a single attorney or one trustee administering the trust, unless that trustee is a trust corporation. Provisions in the Enduring Powers of Attorney Ordinance will also be repealed, so that the issue is exclusively governed by the Ordinance. Most Trust deeds will need amendment if this amended power is to be included;

(f) Amendments to the Perpetuities and Accumulations Ordinance: Both rules are complex and we do not propose to go into any explanatory detail. Suffice to say that the Government proposes that both rules be abolished for private trusts but that the rule against accumulations will be preserved for charitable trusts in a modified form. Any direction in the charity's governing instrument to accumulate income will cease to have effect after 21 years. The changes to the Perpetuities and Accumulations Ordinance will apply to trusts intended to take effect on or after the coming into force of the new legislation. There will be a need to modify the wording of new Trust Deeds and do away with standard wording which has been enshrined in standard trust deeds for many years.

1.7 Summary: All Trustees will need to consider or take advice on the final amendments to the Ordinance when they are passed. Some review in advance of the amendments is advisable. How far some amendments not required can be excluded will depend on the final wording in the amended Ordinance. It should not be forgotten that settlors and possibly beneficiaries will need to be consulted if it is thought necessary to amend existing trust deeds. We are of the view that it will be necessary to amend most old style trust deeds and certainly in relation to the statutory duty of care of trustees that will be imposed, and exemptions from liability clauses, some modifications will almost certainly be required by trustees. Our preference in recent years has been to follow simple and modern trust deed precedents giving wide discretions to Trustees and we employ deeds that are favoured by James Kessler, a leading equity lawyer at the UK bar.

2. Other Topical issues in Brief:

2.1 Extension of the Domain Name System: Most clients will have heard that ICANN has brought in sweeping changes to the internet by introducing new generic Top Level Domain Name (gTLD(s)). It would be advisable for clients to review the list as soon as possible to see if there are any applications identical or similar to their own brands. To check names go to: <http://newgtlds.icann.org/en/program-status/application-results/strings-120outc-13jun12-en>. A gTLD for a generic term that could be construed to cover

a product or service similar to your business may be of concern, and it may be of even greater concern if the applicant is a key competitor. Rights to object are available. Trademark owners can register their trademarks at the "Trademark Clearinghouse" kept through ICANN. The benefits through registering include automatic notification if a new domain wishes to use your mark, putting all new domain registrants on notice if they wish to use your mark and decreased likelihood that your brand will be misused.

- 2.2 **Checking Facebook of potential Employees:** While it may seem collection of personal information from the facebook page of a prospective employee should not raise any privacy issues (most should be public information) but care may be needed in respect of information that may be deemed private. Personal information in terms of the HK legislation is best collected direct from the applicant who may well have rights to ask if an employer holds information collected from other sources without permission. Best practice would to ask a prospective employee for a right of access to the facebook page.
- 2.3 **Best endeavours undertakings:** In the course of commercial negotiations parties often give best endeavours undertakings thinking that such an undertaking may fall short of a binding legal obligation and not give rise to any potential financial loss.. However a recent Court of Appeal decision in the UK (Jet2.com Ltd V Blackpool Airport Ltd(2012) EWCA Civ 417) shows that a “ best endeavours” undertaking or commitment may impose more onerous obligations that might have been expected. Indeed, the party giving the undertaking was obliged to keep an airport open (at considerable financial loss) for aircraft operation on the basis that both sides knew, without expressly stating it, that this must be so for the whole operation to be profitable. While the case is fact specific (and one judge dissented) parties in commercial negotiations would do well to carefully consider whether it might be better to expressly set out the specific obligations rather than use what may be the loose wording of a best endeavours clause;
- 2.4 **Privacy Issues- Cloud Computing:** If a cloud computing provider hosts personal data, then it is obvious that the safety of data privacy is a major consideration. The main difference between cloud computing and traditional computing is that the customer’s data is hosted on a remote server. The server may be operated by the cloud computing provider or by some other party It may be located in Hong Kong or overseas.

If a cloud computing provider is based in Hong Kong, one might have expected that it would be subject to the Personal Data (Privacy) Ordinance (the Ordinance). However, this is not necessarily the case, as a cloud computing provider is not considered to be a "data user" for the purposes of the Ordinance if it holds, processes or uses personal data solely on behalf of its customers, and not for its own purposes.

If a cloud computing provider is based outside Hong Kong, then it may or may not be subject to privacy laws similar to those of the territory. Many such providers are based in countries which do not have privacy laws at all.

Before entering into an arrangement with a cloud computer provider clients should consider conducting a Privacy Impact Statement. The Privacy Commissioner in HK has published guidance on conducting Privacy Impact Assessments. Basically the study will identify what personal data is collected and how that personal data will be collected, used, disclosed and stored and analyse the possible privacy impacts of the cloud computing solution. It will also identify and recommend options for managing, minimising or eradicating these impacts.

2.5 Abolition of Capital Duty- Reduction of BR fees: From 1/6/12 capital duty currently levied on HK companies in respect of an increase in share capital will be abolished. Reduced business registration fees for main BR certificate and Branch certificates will apply from 1/4/12 to 31/3/13;

2.6 Re- Invoicing Companies in HK: The HK IRD continues to relentlessly audit HK trading companies that are basically re- invoicing companies which from a HK tax perspective have no operations in HK. We continue to recommend to clients that advice over structuring of the HK company's operations should be first step so as to be sure that in the event of an audit proper documentation and procedures are in place. An audit by the HK IRD may take years to finalise and involve large legal and accountancy fees, whereas production of proper documentation and evidence of purely offshore operations at an early stage may stop an IRD audit in its tracks. We offer advice on HK trading structures.

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