

Hong Kong proposes introducing a company re-domiciliation regime

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In brief

Many multinational enterprises (MNEs), including those based in Hong Kong, have traditionally set up companies in low or no tax jurisdictions to hold their investments or undertake specific business activities for various reasons, including relatively simple compliance obligations and less onerous information disclosure requirements.

However, these jurisdictions have come under increasing global scrutiny in recent years and have been compelled to enact various new legislations to strengthen their corporate and tax governance, including the economic substance rules starting from 2019. It is also understood that they have stepped up their enforcement action and some companies have been fined for failing to comply with the economic substance rules.

Coupled with other additional disclosure requirements, as well as the imminent implementation by jurisdictions around the world of a new global minimum corporate tax of 15% for in-scope MNE groups (i.e. the Global Anti-Base Erosion rules or GloBE rules), some MNEs with subsidiaries in these offshore jurisdictions are mulling over restructuring or exiting these jurisdictions entirely.

There are also situations where historical structures are no longer giving the expected outcome, for instance due to the inability to maintain the relevant substance needed for enjoying treaty benefits.

The Government's recent proposal to introduce a company re-domiciliation regime in Hong Kong may offer a cost-effective restructuring alternative to these MNEs. Unlike the current common Hong Kong entry options for foreign companies such as establishing a new company in Hong Kong and winding up the old company in its original place of incorporation upon business transfer, re-domiciliation would enable a foreign-incorporated company to change its domicile to Hong Kong whilst maintaining its legal identity. This gives companies maximum continuity over business operations and substantially reduces administrative complexity and compliance burden compared to other routes of relocating to Hong Kong.

This news flash provides an overview of the proposed regime and our observations thereon.

In detail

Background

Since 2021, Hong Kong has already put into place re-domiciliation mechanisms for open-ended fund companies and limited partnership funds to attract existing foreign funds to establish and operate in Hong Kong.

As a further step to strengthen Hong Kong's position as a global business and financial hub, the Financial Secretary announced in the 2023/24 Budget the introduction of a company re-domiciliation regime to facilitate non-Hong Kong companies to re-domicile to Hong Kong. The Financial Services and the Treasury Bureau then conducted a public consultation to solicit views on the key features of the proposed regime outlined in the consultation paper titled *Proposed company re-domiciliation regime in Hong Kong* (the Consultation Paper)¹.

Subject to the views collected in the public consultation, the relevant legislative amendment instrument is targeted to be submitted to the Legislative Council in 2023/2024.

Entry criteria and key features of the proposed re-domiciliation regime in Hong Kong

The Consultation Paper proposes amending the Companies Ordinance (CO) to introduce an inward re-domiciliation regime with the following key features:

- the proposed regime will be applicable to the five types of companies that can be formed in Hong Kong under the CO including (1) private companies limited by shares; (2) public companies limited by shares; (3) companies limited by guarantee without a share capital; (4) private unlimited companies with a share capital; and (5) public unlimited companies with a share capital; as well as the types of companies comparable to the five mentioned company types in their original place of incorporation;
- no economic substance test will be imposed on the companies applying for re-domiciliation, i.e. the proposed regime will generally be applicable to companies of different types and scale²;
- the re-domiciliation process would not affect the property, rights, obligations and liabilities, as well as the relevant contractual and legal processes of the companies applying for re-domiciliation (including their tax obligation to the originating jurisdiction); and
- provisions will be put in place to ensure that upon successful completion of the re-domiciliation, the re-domiciled company will retain its identity, i.e. no new legal entity is created throughout the process.

Administration and approval of re-domiciliation application

The Consultation Paper further proposes that appropriate check and balance measures will be introduced to ensure that companies re-domiciling to Hong Kong are of good standing and will not prejudice the integrity of Hong Kong's business environment:

- the Registrar of Companies (R of C) will be responsible for approving applications for re-domiciliation to consider whether the companies have fulfilled specified requirements in relation to integrity, member and creditor protection and solvency;
- the R of C will also be empowered to impose other conditions on the companies applying for re-domiciliation depending on circumstances of each individual case;
- the incoming company should make an application to the R of C with the required documents and application fee (amount to be determined). Examples of the required documents include the latest audited financial statements of the company as at a date no more than three months prior to the application date and directors' confirmation that the company has complied with the requirements of the law of its place of incorporation in relation to the re-domiciliation³;
- upon successful application, the R of C will issue a certificate of re-domiciliation. The company concerned would then be required to notify the R of C and provide evidence of de-registration in its original place of incorporation within 60 days⁴ in order to complete the re-domiciliation process.

Our observations: *It is not clear from the Consultation Paper whether a foreign company applying for re-domiciliation to Hong Kong under the proposed regime must originate from a jurisdiction that permits outward re-domiciliation. There is also no indication in the Consultation Paper whether the Government will consider introducing an outward re-domiciliation alongside an inward one. Hopefully, the Government will provide further clarifications on these issues soon.*

With respect to the types of incoming companies eligible for the proposed regime, there may be practical issues in determining whether a given overseas corporate form qualifies as 'comparable' to that under the CO as this will need to be decided in respect of each incoming type of company / jurisdiction. To ensure that the proposed regime has wide applicability, the R of C may need to adopt a pragmatic approach in vetting applications.

Proposed tax treatment for re-domiciled companies

Hong Kong adopts a territorial basis of taxation. All companies that carry on a trade, profession or business in Hong Kong, regardless of their domicile, are subject to Hong Kong profits tax on profits arising in or derived from Hong Kong from such trade, profession or business.

Nonetheless, to provide certainty to overseas companies on the prospective tax implications upon re-domiciliation to Hong Kong, the Consultation Paper proposes that amendments will also be made to the Inland Revenue Ordinance (IRO) as regards the tax treatments and obligations of the re-domiciled companies. The Inland Revenue Department will also be empowered to address transitional tax matters such as fair deduction or allowances for trading stock, bad debts, impairment losses on financial assets, and depreciation that may have occurred before re-domiciliation.

Our observations: *Prospective tax treatment of the re-domiciled companies is one of the important issues to consider when deciding whether to re-domicile to another jurisdiction. We are pleased to see that necessary consequential amendments will be made to the IRO to address the transitional tax matters. The Government may also need to consider whether specific provisions should be introduced to treat a company that redomiciles to Hong Kong as a Hong Kong resident for the purposes of the IRO, the treaties and the GloBE / domestic minimum top-up tax rules to be implemented.*

For the sake of certainty on the Hong Kong stamp duty implications of re-domiciled companies, the Government should clarify that (i) there will be no stamp duty arising from re-domiciliation as it does not involve any transfer of assets; and (ii) shares in the re-domiciled companies will become Hong Kong stocks upon re-domiciliation where their share registers are placed in Hong Kong and subsequent transfer of such shares will be subject to stamp duty.

The takeaway

We welcome the Government's proposal to introduce an inward re-domiciliation regime in Hong Kong. Companies which are already economically active in Hong Kong but now domiciled abroad would plausibly find the proposed regime attractive and well timed in light of the recent developments in the international tax landscape. It also provides an alternative way for business restructuring in Hong Kong going forward. Nonetheless, the overall attractiveness of the proposed regime is likely to depend upon the extent to which the legal and tax implications are clear and well understood by business communities.

While we await the legislative bill which will hopefully sort out corporate governance, legal and tax considerations, companies that are interested in re-domiciling to Hong Kong may wish to start mapping out the plan now. As always, seeking professional advice in the process is advisable given the potential technical complexity involved.

Endnotes

1. The Consultation Paper can be accessed via this link:
[https://www.fstb.gov.hk/fsb/en/publication/consult/doc/Public%20consultation%20paper%20\(e\)_for%20issue.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/Public%20consultation%20paper%20(e)_for%20issue.pdf)
2. The re-domiciliation regime of most jurisdictions does not mandate an economic substance test, except for Singapore, which requires the inward re-domiciling companies to meet any two of the following criteria; (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; and (iii) the foreign corporate entity has more

than 50 employees.

3. Examples of the required documents are set out in the Appendix to the Consultation Paper. Hopefully, the Government will consider practical alternatives in circumstances where certain documents are not readily available (e.g. where the originating jurisdiction does not have any audit requirements).
4. R of C may on application extend the 60-day period, subject to any condition considered appropriate.

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