

# Share capital restructuring for companies in Hong Kong

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**Capital restructuring has become increasingly common due to changing market conditions. Companies in Hong Kong can take advantage of the new Companies Ordinance (Cap 622) by reviewing their capital structure to grow their business.**

In Hong Kong, a company limited by shares must have share capital, which is represented by shares in the company. Share capital paid by shareholders is maintained to meet the company's liabilities and to protect creditors; capital cannot be paid back unless prescribed procedures have been completed.

The new Companies Ordinance came into effect on 3 March 2014. Since then, the court-free procedures for reducing share capital and amalgamating wholly-owned companies within the same group have been well- received by the market.

According to the Companies Registry, the number of cases handled for these two court-free options for the years 2014 to 2016 are detailed below.

**Fig. 1: Number of cases handled for two court-free options**

	2014	2015	2016	Total
Reduction of Capital	102	176	235	513
Court Free Procedures (new)	92	173	235	500
By Court Order	10	3	0	13
Amalgamation (new)	11	32	32	75

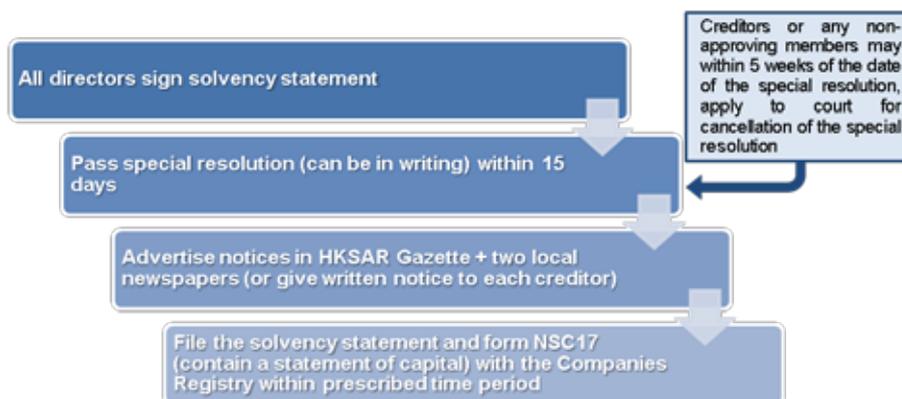
Source: Prepared by TMF HK based on statistics of the Companies Registry

## Court-free capital reduction

The alternative court-free procedure for the reduction of capital, which is based on the solvency test, applies to all Hong Kong companies as well as to those cases where capital is used to offset against accumulated losses so

as to put the company in a position to declare dividend payment to its shareholders when it subsequently derives distributable profits. This is a faster and cheaper option compared to the court-sanctioned process (Fig.2).

**Fig. 2: Outline of major procedures for a court-free capital reduction**



Source: TMF HK

**Members' voluntary liquidation**

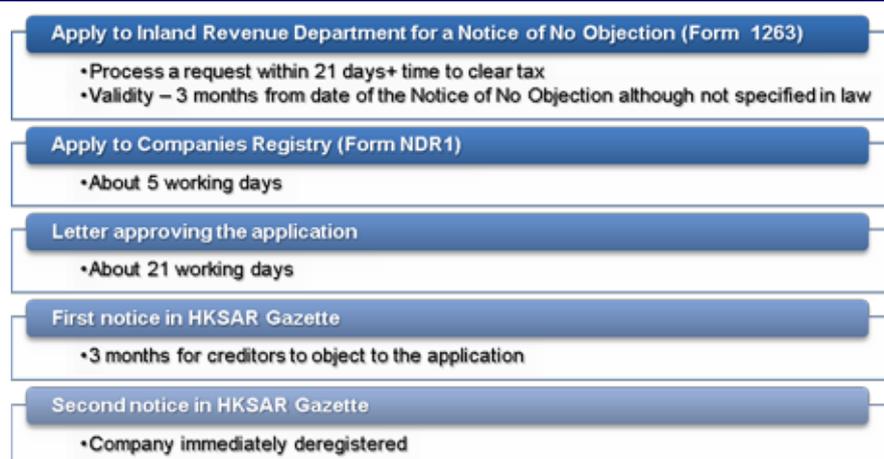
Members' voluntary liquidation is an alternative option to going through the capital reduction process. If the relevant Hong Kong company will ultimately not be needed, disposing the company through members' voluntary liquidation may allow a return of surplus assets to the company's shareholders in a more tax efficient and cost effective manner.

**Fig. 3: Outline of major procedures for a members' voluntary liquidation**



Source: TMF HK

However, for tax or other reasons, liquidation may not be a preferred option. In such circumstance, companies may first reduce their paid-up share capital and then apply for deregistration pursuant to Section 750 of the Companies Ordinance.

**Fig. 4: Outline of major procedures for an application for deregistration**

Source: TMF HK

**Declaration of dormancy**

If it is the members' intention to keep a company for preserving the company name or tax loss, members may declare the company dormant pursuant to Section 5 of the Companies Ordinance.

In general terms, a company is considered to be dormant during any period in which no accounting transaction occurs. According to section 2 of the Companies Ordinance, accounting transaction, in relation to a company, means a transaction that is required by Section 373 to be entered in the company's accounting records, excluding a transaction arising from the payment of any fee that the company is required by an Ordinance to pay.

The procedure for a company to become dormant does not apply to: (i) a company that is not a private company; or (ii) a private company that is specified in Section 5(7) of the Companies Ordinance.

In order to become dormant, a private company (subject to the abovesaid exception) should pass a special resolution to declare that the company will become dormant either from the date of delivery of the special resolution to the Registrar of Companies, or from a later date as specified therein. The company will then be deemed in a dormancy status from the date of delivery of the special resolution, or from the specified later date as applicable.

A dormant company will cease to be dormant if (i) a special resolution declaring that the company intends to enter into an accounting transaction is delivered to the Registrar of Companies for registration; or (ii) there is an accounting transaction in relation to the company.

Once a company declares dormant pursuant to the said Section 5, it will be exempted from certain statutory requirements, such as the holding of annual general meetings, filing of annual returns, appointment of auditors and preparation of audited financial statements. However the company will still be required to comply with other statutory requirements according to the Companies Ordinance, Business Registration Ordinance (Cap 310) and Inland Revenue Ordinance (Cap 112).

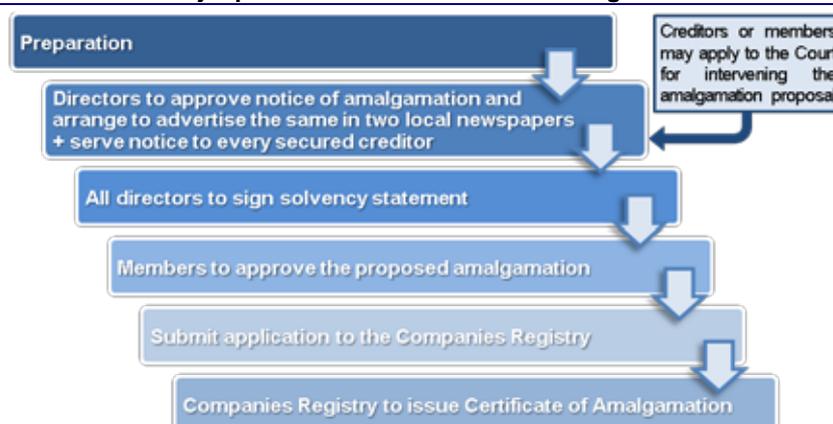
The minimum on-going compliance requirements of a dormant company normally include (a) having a named secretary who is resident or registered in Hong Kong; (b) having a registered office address in Hong Kong; (c) annual filing of the Employer's Return of Pensions and Remuneration and profits tax return if so required by the Inland Revenue Department; (d) annual renewal of the Business Registration Certificate and payment of the relevant fee; (e) keeping of the statutory books and records in Hong Kong; (f) filing of specified forms to the Companies Registry in relation to all corporate changes occurred, and (g) maintenance of the company's accounting books and records.

### Court-free amalgamation

The introduction of the court-free amalgamation makes it easier for a group of companies to restructure and streamline business. The amalgamation can be in a vertical or a horizontal form subject to a solvency test. There are other conditions to be satisfied before this option can be used.

Once the amalgamation has been approved and takes effect, each amalgamating company will cease to exist as an entity separating from the amalgamated company; the amalgamated company succeeds to all the property, rights and privileges, as well as all liabilities and obligations of each amalgamating company.

**Fig. 5: Outline of major procedures for a court-free amalgamation**



Source: TMF HK

Please note that amalgamation may trigger events of default in commercial and financing documents of an amalgamating company or not be recognized in other jurisdiction. There may also be foreign tax implications upon transfer of business or assets which are located outside the Hong Kong territory upon the amalgamation. It is therefore advisable to seek proper legal and tax advice in the jurisdiction concerned before proceeding with this option.

Profits tax consequences of a court-free amalgamation under the Companies Ordinance may not be the same as those in specific private merger ordinances in Hong Kong or in universal succession cases under foreign laws. If the court-free amalgamation is not carried out for the

purpose of obtaining tax benefits in the opinion, the amalgamated company will generally be treated as far as possible as if it is the continuation of and the same person as the amalgamating company for the purposes of the Inland Revenue Ordinance. You may click to this link [http://www.ird.gov.hk/eng/tax/bus\\_cfa.htm](http://www.ird.gov.hk/eng/tax/bus_cfa.htm) for details of the views expressed by the Inland Revenue Department on amalgamation.

### Other forms of capital restructuring

The new Companies Ordinance also allows other forms of alteration to existing capital structure of a Hong Kong company such as the increase in its share capital, capitalization of profits and issue of bonus shares with or without allotment of new shares, conversion of all or any of its shares into a larger or smaller number of shares; and cancellation of shares which have not been taken or agreed to be taken by any person; or have been forfeited.



#### **Frances Chan**

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Frances specialises in corporate secretarial and liquidation services. She has vast experience in corporate governance and has assisted regional and international clients in establishing presences in Hong Kong and certain offshore jurisdictions, project co-ordination, corporate restructuring, administration and management. Frances worked in the insolvency field for 9 years before joining the company secretary profession. She was a Director and Head of Corporate Secretarial of KCS Hong Kong Limited until the KCS Group was acquired by TMF in end August 2014. She formerly worked for KPMG Hong Kong.

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