Bills Committee
on Companies (Amendment) Bill 2004

Follow-up Actions Arising from the Discussion at the Meeting on 15 March 2005

PURPOSE

At the Bills Committee meeting held on 15 March 2005, Members requested the Administration to provide additional information on and clarify a number of matters relating to the Companies (Amendment) Bill 2004 (the Bill). Having consulted the Department of Justice (D of J) and the Hong Kong Institute of Certified Public Accountants (HKICPA), we set out the relevant information in the following paragraphs.

RELEVANT PROVISIONS OF LAWS QUOTED

(a) To provide copies of the following relevant provisions –

(i) Paragraph 10 of Schedule 10A to the United Kingdom Companies Act 1985 (the UK Act) on which section 3(3) of the proposed 23rd Schedule is modelled;

(ii) Sections 146 and 162C of the UK Act; and

(iii) Sections 49A and 49B of the Companies Ordinance (Cap. 32, CO).

2. The relevant provisions in the company laws of the UK and Hong Kong are at **Annexes A and B respectively**.

SECTION 3(3) of THE PROPOSED TWENTY-THIRD SCHEDULE

(b) The original purpose(s) to be achieved by section 3(3) of the proposed Twenty-third Schedule;

(c) The justifications for the Administration's current proposal of removing section 3(3);

(d) Whether the word "held" refers to "directly held" and/or "indirectly held";

3. As set out in our reply dated 23 November 2004 to the Assistant Legal Adviser (LC Paper No. CB(1)453/04-05(17)) and responses to the submission from the Law Society (LC Paper No. CB(1)681/04-05(02)), section 3(3) of the proposed Twenty-third Schedule[1] was modelled on paragraph 10 of Schedule 10A of the UK Act[2]. The hitherto intention was to cater for a situation where a subsidiary undertaking, vis-à-vis other right holders, acquired voting rights in itself. We believed then that this meant the case when the subsidiary undertaking held certain voting rights in the parent undertaking, hence *indirectly* holding voting rights in itself.

4. In view of the further questions on the application of section 3(3), we have sought further clarification from the Department of Trade and Industry (DTI) of the UK in January 2005. As set out in the Administration's subsequent paper entitled "Follow-up Actions Arising from the Discussion at the Meeting on 13 January 2005" (LC Paper No. CB(1)825/04-05(02)), we have been advised that interpretation of the relevant provisions in the UK Act is a matter for the court in the UK. However, our attention have been drawn to the observation that it is generally considered that paragraph 10 of Schedule 10A to the UK Act should be read as applying to **voting rights in an undertaking held by the same undertaking itself**. We have been advised that the relevant UK provision is not taken to apply to a cross-shareholding scenario between parent and subsidiary undertakings.

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1 Section 3(3) of the proposed Twenty-third Schedule reads –
"The voting rights in an undertaking referred to in subsection (1) shall be reduced by any rights held by the undertaking itself."

2 Paragraph 10 of Schedule 10A to the UK Companies Act 1985 reads –
"The voting rights in an undertaking shall be reduced by any rights held by the undertaking itself."

5. Accordingly, further research has thus been undertaken. According to our legal adviser's understanding as set out in the Administration's paper entitled "Follow-up Actions Arising from the Discussion at the Meeting on 3 February 2005" (LC Paper No. CB(1)1077/04-05(02)), where a UK public company acquires its own shares under certain circumstances, section 146 of the UK Act provides that the company is entitled to hold those shares for three years (or one year in certain circumstances) after which such shares must be cancelled. During this period, the company cannot exercise any voting rights in respect of such shares. Furthermore, section 162C of the UK Act permits certain companies to hold under certain circumstances their own shares, which are termed "treasury shares", but prohibits them against exercising any rights in respect of those shares. In view of the above, it looks that paragraph 10 of Schedule 10A to the UK Act applies to such a company with the result that rights held by the company itself shall be reduced for the purpose of determining the "parent and subsidiary" relationship.

6. In Hong Kong, a company is not allowed to be a member of itself[3], except where statute otherwise provides. Sections 49A and 49B of the CO permit a company to redeem or purchase its own shares. However, according to section 49A(4) of the CO, shares redeemed by a company under section 49A shall be cancelled on redemption. By virtue of section 49B(3), the same applies to the purchase by the company of its own shares under section 49B. Consequently, voting rights in respect of these shares would be extinguished altogether. Furthermore, there is no equivalent of sections 146 and 162C of the UK Act in the CO whereby a company is allowed to hold its own shares under those circumstances. In any case, the existing tests of determining "parent and subsidiary" relationship of two companies under sections 2(4) to (7) of the CO[4] do not contain a reduction rule of voting rights equivalent to section 3(3) of the proposed Twenty-third Schedule. We are not aware of any difficulties in applying sections 2(4) to (7) of the CO in this aspect. In view of the above considerations, we do not see the need to introduce a reduction rule equivalent to section 3(3) for determining whether a body corporate is a subsidiary of another body corporate.

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3 *Trevor v Whitworth* [1887] 12 App Cas 409; *Kirby v Wilkins* [1929] 2 Ch 444.

4 See **Annex B** for the relevant provisions.

7. Moreover, we have further consulted the HKICPA and the D of J and are advised that section 3(3) of the proposed Twenty-third Schedule appears to have little relevance in Hong Kong. We are not aware of any real life situation where a subsidiary undertaking which is not a body corporate holds voting rights in the same undertaking itself. Even where such a situation exists, since the undertaking is not prohibited to exercise such rights, we do not see the need for a reduction rule to discount such voting rights. Accordingly, we are of the view that we should consider proposing a Committee Stage Amendment (CSA) to remove section 3(3).

(e) Whether section 3(3) is applicable to the following scenarios:

(1) A parent undertaking ("A") has two fully-owned subsidiary undertakings ("B" which is a body corporate and "C" which is not a body corporate). Both "B" and "C" hold certain shares and voting rights of "A";

(2) A parent undertaking ("A") has two partially-owned subsidiary undertakings ("D" which is a body corporate and "E" which is not a body corporate). Both "D" and "E" hold certain shares and voting rights of "A";

8. We have illustrated a similar scenario as depicted in diagram 2 and paragraphs 4 to 6 in our paper entitled "Follow-up Actions Arising from the Discussion at the Meeting on 13 January 2005" (LC Paper No. CB(1)825/04-05(02)). For illustrative purpose, and notwithstanding that we have now come to the view that section 3(3) of the proposed Twenty-third Schedule should be removed from the Bill, we consider that the proposed subsection in question has no application to the two scenarios.

9. For scenario (1), it should first be pointed out that, by virtue of section 28A(1) of the CO[5], "B" as a body corporate cannot be a member of the company "A", which is its holding company, in general situations. We are however not aware of any rule to prohibit an undertaking, being not a body corporate, to hold shares in its holding company. This notwithstanding, even if "B" and "C" do hold certain

[5] See **Annex B** for the relevant provisions.

shares and voting rights of "A", section 3(3) does not apply, as the provision should be read as "the voting rights in an undertaking (i.e. voting rights in either "B" or "C") shall be reduced by any rights held by the undertaking itself (i.e. voting rights in either "B" or "C" held by either of them itself)". As neither "B" nor "C" holds its own voting rights but the voting rights of "A", section 3(3) has no application.

10. For scenario (2), it makes no difference even though the subsidiary undertakings of "A" are partially owned by it. The same position as stated in paragraph 9 applies.

(f) In a situation where a company "A" invests in a fund, which holds shares in another company "B", which in turn holds shares in "A", please explain with the relevant provisions and/or accounting rules:

(i) How any parent and subsidiary relationship between the entities is determined;

(ii) How the group accounts of the entities are prepared;

(iii) Whether section 3(3) is applicable;

11. For the purpose of determining a "parent and subsidiary" relationship for preparation of group accounts, and assuming the fund falls within the definition of "undertaking" in section 1 of the proposed Twenty-third Schedule[6], section 2 of the proposed Twenty-third Schedule or section 2(4) of the CO would apply in the above situation. If a company "A" invests in a fund on which it has the right to exert "control" by satisfying any of the criteria set out in section 2(1) of the proposed Twenty-third Schedule or section 2(4) of the CO, the fund may become its subsidiary undertaking. The same formula applies to determine the "parent and subsidiary" relationship between the fund and the other company "B", the shares of which are held by the fund.

12. The HKICPA has illustrated how the group accounts of these entities are prepared, as set out in **Annex C**. It should be noted that how this situation should be dealt with under Hong Kong Accounting Standard

[6] Under the Bill, a company does not need to consolidate the accounts of a "fund" as its subsidiary undertaking if the "fund" does not fall with the definition of "undertaking" as set out in section 1 of the proposed Twenty-third Schedule.

(HKAS) 32[7], and such accounting would not affect the determination of "parent and subsidiary" relationship.

13. Again, section 3(3) of the proposed Twenty-third Schedule has no application in this scenario. As illustrated in paragraphs 4 and 9 above, the "voting rights in the fund", the "voting rights in Company 'B'", and the "voting rights in Company 'A'" in this prescribed situation are different sets of rights, each of which cannot be meaningfully reduced by one another.

(g) How a parent company should deal with shares of itself held, not directly by the company, but through a subsidiary company.

14. As explained in paragraph 9 above, section 28A(1) of the CO prohibits a body corporate, subject to the exceptions set out in the section, from being a member of a company which is its holding company, and any allotment or transfer of shares in a company to its subsidiary shall be void. Even if a "parent company" does hold shares through a "subsidiary company" under the exceptional circumstances, there are no requirements in the existing CO to require that voting rights attached to such rights be reduced for the purpose of ascertaining the "parent company" of the first-mentioned "parent company" (i.e. the grandparent).

15. According to the HKICPA, the accounting standard HKAS 32 has dealt with how this situation should be accounted for, and such accounting would not affect the determination of "parent and subsidiary" relationship.

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[7] Paragraph 33 of HKAS 32 "*Financial Instruments: Disclosure and Presentation*" states that "(i)f an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognized in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognized directly in equity."

(h) The purpose(s) of the proposed section 123(4).

16. The proposed section 123(4)[8] is intended to *expressly* require directors to give additional information as may be necessary to give a true and fair view, where compliance with the requirements of the Tenth Schedule and other requirements of the CO as to the matters to be included in a company's accounts would not be sufficient to give a true and fair view of the state of affairs or the profit or loss of the company.

(i) To review subsections (1), (2), (3), (4) and (4A) of section 123[9] to address Members' concern that there is overlap between the existing and proposed provisions.

17. We have sought the advice of the D of J on the question of whether the existing subsection (1) overlaps with the proposed subsection (4). According to D of J, to a certain extent, subsection (1) overlaps with subsection (4) since both require the accounts to give a true and fair view. However, this does not automatically render the proposed subsection (4) unnecessary. What subsection (4) seeks to achieve is to give a specific example of what is meant by the duty to give a true and fair view, as required under subsection (1), and how the "true and fair view override" rule applies. It is not rare in the CO where a provision imposes a general duty, followed by imposition of specific duties[10].

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[8] The Bill proposed that the existing section 123(4) should be repealed and the following substituted –

"(4) Without affecting the generality of subsections (2) and (3), where compliance with the requirements of the Tenth Schedule and other requirements of this Ordinance as to the matters to be included in a company's balance sheet and profit and loss account or in a statement annexed to the account would not be sufficient to give a true and fair view of the state of affairs or the profit or loss of the company, additional information as may be necessary to give a true and fair view thereof shall be given in the account or statement, as the case may require.

(4A) Where compliance with any of the provisions referred to in subsections (2), (3) and (4) is inconsistent with the requirement to give a true and fair view of the state of affairs or the profit or loss of a company, the directors of the company shall depart from those provisions to the extent as may be necessary for the purposes of subsection (1) with the reasons for and particulars and effects of such departure to be given in the company's balance sheet and profit and loss account or in a statement annexed thereto."

[9] See **Annex B** for the relevant existing provisions.

[10] For example, section 107(1) of the CO requires every company shall make an annual return in the specified form, which shall contain such particulars as specified therein. Section 107(2) then proceeds to require that a return shall state the information prescribed in that subsection, without prejudice to the generality of subsection (1). The provisions have been extracted in **Annex B**.

Indeed, the proposed subsections (4) and (4A) have shown clearly that subsection (1) is overriding. That said, in response to Members' concerns, we would consider proposing a CSA to expressly provide that the proposed subsection (4) should not affect the generality of the existing subsection (1).

18. As regards the concern over possible overlap between the existing subsection (3) and the proposed subsection (4), the proposed subsection (4) already provides expressly that it does not affect the generality of subsection (3). There is thus no question of subsection (4) affecting the application and interpretation of subsection (3).

19. We are aware that there may be a question about whether we should repeal subsection (3). We agree that, to a certain extent, subsection (3) may become redundant with the addition of the proposed subsection (4), as the latter is indeed prescribing the situation where compliance with the Tenth Schedule and other requirements of the CO as to the matters to be included in the accounts would not be sufficient to give a true and fair view. The same situation can be anticipated in subsection (3) which specifies that, save in the exceptions, the application of the Tenth Schedule shall not be prejudicial to the general requirements in subsection (1) and other CO requirements. However, the repeal of subsection (3) will open up other questions in relation to the existing operation of this subsection. As subsection (3) refers to Part III of the Tenth Schedule (concerning the accounting requirements for banking and insurance companies) and any other requirements of the CO, the repeal of subsection (3) is Ordinance will have implications far beyond the purpose of the Bill.

20. In this light, we would propose maintaining the status quo, i.e. retaining subsection (3), subject to a CSA to be explained further in paragraph 21 below. In any case, the proposed subsection (4) will not affect the interpretation of subsection (3) because subsection (4) is without prejudice to subsection (3). We would separately invite the Standing Committee on Company Law Reform and the Joint Government / HKICPA Working Group, which is tasked to review the accounting and auditing provisions of the CO, to examine the wider implications for the operation of subsection (3).

21. In the course of our legal adviser's review of subsection (3), she is not able to locate any provisions in the existing subsections (4) to (7) and proposed subsections (4) to (4A) which can be regarded as an exception to subsection (3). We note that the existing subsection (3) was enacted in 1974 and was modelled on section 149(3) of the UK Companies Act 1948[11], which has been subsequently repealed by virtue of the UK Companies Act 1985. D of J advised that at least the first part of the exception (i.e. "the following provisions of this section") in subsection (3) could well be repealed. Accordingly, we would consider proposing a CSA to remove the words "in the following provision of this section or" in subsection (3).

(j) To provide copies of section 227A and other relevant provisions in the UK Act on which the "true and fair view override" provisions in the Bill are modelled.

22. The relevant provisions are at **Annex A**.

Financial Services and the Treasury Bureau
April 2005

[11] See **Annex A** for the relevant provisions.

Annex A

UK Companies Act 1948 (Repealed) (English version only)

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(1) Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.

(2) A company's balance sheet and profit and loss account shall comply with the requirements of the Eighth Schedule to this Act, so far as applicable thereto.

(3) Save as expressly provided in the following provisions of this section or in Part III of the said Eighth Schedule, the requirements of the last foregoing subsection and the said Eighth Schedule shall be without prejudice either to the general requirements of subsection (1) of this section or to any other requirements of this Act.

(4) The Board of Trade may, on the application or with the consent of a company's directors, modify in relation to that company any of the requirements of this Act as to the matters to be stated in a company's balance sheet or profit and loss account (except the requirements of subsection (1) of this section) for the purpose of adapting them to the circumstances of the company.

(5) Subsections (1) and (2) of this section shall not apply to a company's profit and loss account if-
(a) the company has subsidiaries; and
(b) the profit and loss account is framed as a consolidated profit and loss account dealing with all or any of the company's subsidiaries as well as the company and-
(i) complies with the requirements of this Act relating to consolidated profit and loss accounts; and
(ii) shows how much of the consolidated profit or loss for the financial year is dealt with in the accounts of the company.

(6) If any person being a director of a company fails to take all reasonable steps to secure compliance as respects any accounts laid before the company in general meeting with the provisions of this section and with the other requirements of this Act as to the matters to be stated in accounts, he shall, in respect of each offence, be liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding two hundred pounds:
Provided that-
(a) in any proceedings against a person in respect of an offence under this section, it shall be a defence to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that the said provisions or the said other requirements, as the case may be, were complied with and was in a position to discharge that duty; and
(b) a person shall not be sentenced to imprisonment for any such offence unless, in the opinion of the court dealing with the case, the offence was committed wilfully.

(7) For the purposes of this section and the following provisions of this Act, except where the context otherwise requires,-
(a) any reference to a balance sheet or profit and loss account shall include any notes thereon or document annexed thereto giving information which is required by this Act and is thereby allowed to be so given; and
(b) any reference to a profit and loss account shall be taken, in the case of a

company not trading for profit, as referring to its income and expenditure account, and references to profit or to loss and, if the company has subsidiaries, references to a consolidated profit and loss account shall be construed accordingly.

UK Companies Act 1985 (English version only)

Current through 18 February 2005

146 Treatment of shares held by or for public company

(1) Except as provided by section 148, the following applies to a public company--

(a) where shares in the company are forfeited, or surrendered to the company in lieu, in pursuance of the articles, for failure to pay any sum payable in respect of the shares;
(aa) where shares in the company are surrendered to the company in pursuance of section 102C(1)(b) of the Building Societies Act 1986;
(b) where shares in the company are acquired by it (otherwise than by any of the methods mentioned in section 143(3)(a) to (d)) and the company has a beneficial interest in the shares;
(c) where the nominee of the company acquires shares in the company from a third person without financial assistance being given directly or indirectly by the company and the company has a beneficial interest in the shares; or
(d) where a person acquires shares in the company with financial assistance given to him directly or indirectly by the company for the purpose of or in connection with the acquisition, and the company has a beneficial interest in the shares.
Schedule 2 to this Act has effect for the interpretation of references in this subsection to the company having a beneficial interest in shares.

(2) Unless the shares or any interest of the company in them are previously disposed of, the company must, not later than the end of the relevant period from their forfeiture or surrender or, in a case within subsection (1)(b), (c) or (d), their acquisition--
(a) cancel them and diminish the amount of the share capital by the nominal value of the shares cancelled, and
(b) where the effect of cancelling the shares will be that the nominal value of the company's allotted share capital is brought below the authorised minimum, apply for re-registration as a private company, stating the effect of the cancellation.

(3) For this purpose "the relevant period" is--
(a) 3 years in the case of shares forfeited or surrendered to the company in lieu of forfeiture, or acquired as mentioned in subsection (1)(b) or (c);
(b) one year in the case of shares acquired as mentioned in subsection (1)(d).

(4) The company and, in a case within subsection (1)(c) or (d), the company's nominee or (as the case may be) the other shareholder must not exercise any voting rights in respect of the shares; and any purported exercise of those rights is void.

162C Treasury shares: voting and other rights

(1) This section applies to shares which are held by a company as treasury shares ("the treasury shares").

(2) The company must not exercise any right in respect of the treasury shares, and any purported exercise of such a right is void.

(3) The rights to which subsection (2) applies include any right to attend or vote at

meetings (including meetings under section 425).

(4) No dividend may be paid, and no other distribution (whether in cash or otherwise) of the company's assets (including any distribution of assets to members on a winding up) may be made, to the company in respect of the treasury shares.

(5) Nothing in this section is to be taken as preventing--
(a) an allotment of shares as fully paid bonus shares in respect of the treasury shares, or
(b) the payment of any amount payable on the redemption of the treasury shares (if they are redeemable shares).

(6) Any shares allotted as fully paid bonus shares in respect of the treasury shares shall be treated for the purposes of this Act as if they were purchased by the company at the time they were allotted, in circumstances in which section 162A(1) applied.

226A Companies Act individual accounts

(1) Companies Act individual accounts must comprise--
(a) a balance sheet as at the last day of the financial year, and
(b) a profit and loss account.

(2) The balance sheet must give a true and fair view of the state of affairs of the company as at the end of the financial year; and the profit and loss account must give a true and fair view of the profit or loss of the company for the financial year.

(3) Companies Act individual accounts must comply with the provisions of Schedule 4 as to the form and content of the balance sheet and profit and loss account and additional information to be provided by way of notes to the accounts.

(4) Where compliance with the provisions of that Schedule, and the other provisions of this Act as to the matters to be included in a company's individual accounts or in notes to those accounts, would not be sufficient to give a true and fair view, the necessary additional information must be given in the accounts or in a note to them.

(5) If in special circumstances compliance with any of those provisions is inconsistent with the requirement to give a true and fair view, the directors must depart from that provision to the extent necessary to give a true and fair view.

(6) Particulars of any such departure, the reasons for it and its effect must be given in a note to the accounts.

227A Companies Act group accounts

(1) Companies Act group accounts must comprise--
(a) a consolidated balance sheet dealing with the state of affairs of the parent company and its subsidiary undertakings, and
(b) a consolidated profit and loss account dealing with the profit or loss of the parent company and its subsidiary undertakings.

(2) The accounts must give a true and fair view of the state of affairs as at the end of the financial year, and the profit or loss for the financial year, of the undertakings included in the consolidation as a whole, so far as concerns members of the company.

(3) Companies Act group accounts must comply with the provisions of Schedule 4A

as to the form and content of the consolidated balance sheet and consolidated profit and loss account and additional information to be provided by way of notes to the accounts.

(4) Where compliance with the provisions of that Schedule, and the other provisions of this Act as to the matters to be included in a company's group accounts or in notes to those accounts, would not be sufficient to give a true and fair view, the necessary additional information must be given in the accounts or in a note to them.

(5) If in special circumstances compliance with any of those provisions is inconsistent with the requirement to give a true and fair view, the directors must depart from that provision to the extent necessary to give a true and fair view.

(6) Particulars of any such departure, the reasons for it and its effect must be given in a note to the accounts.

SCHEDULE 10A Parent and Subsidiary Undertakings: Supplementary Provisions

10 The voting rights in an undertaking shall be reduced by any rights held by the undertaking itself.

Annex B
(English version only)

Hong Kong Companies Ordinance (Chapter 32)

2. Interpretation

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(4) For the purposes of this Ordinance, a company shall, subject to the provisions of subsection (6), be deemed to be a subsidiary of another company, if-
(a) that other company-
(i) controls the composition of the board of directors of the first-mentioned company; or (Amended 6 of 1984 s. 2)
(ii) controls more than half of the voting power of the first-mentioned company; or
(iii) holds more than half of the issued share capital of the first-mentioned company (excluding any part of it which carries no right to participate beyond a specified amount in a distribution of either profits or capital); or
(b) the first-mentioned company is a subsidiary of any company which is that other company's subsidiary. (Added 80 of 1974 s. 2)

(5) For the purposes of subsection (4), the composition of a company's board of directors shall be deemed to be controlled by another company if that other company by the exercise of some power exercisable by it, without the consent or concurrence of any other person, can appoint or remove all or a majority of the directors, and, for the purposes of this provision, that other company shall be deemed to have power to make such an appointment if-
(a) a person cannot be appointed as a director without the exercise in his favour by that other company of such a power; or
(b) a person's appointment as a director follows necessarily from his being a director or other officer of that other company. (Added 80 of 1974 s. 2)

(6) In determining whether one company is a subsidiary of another company-
(a) any shares held or power exercisable by that other company in a fiduciary capacity shall be treated as not held or exercisable by it;
(b) subject to paragraphs (c) and (d), any shares held or power exercisable-
(i) by any person as a nominee for that other company (except where that other company is concerned only in a fiduciary capacity); or
(ii) by, or by a nominee for, a subsidiary of that other company, not being a subsidiary which is concerned only in a fiduciary capacity,
shall be treated as held or exercisable by that other company;
(c) any shares held or power exercisable by any person by virtue of the provisions of any debentures of the first-mentioned company or of a trust deed for securing any issue of such debentures shall be disregarded; and
(d) any shares held or power exercisable by, or by a nominee for, that other company or its subsidiary (not being held or exercisable as mentioned in paragraph (c)) shall be treated as not held or exercisable by that other company if the ordinary business of that other company or its subsidiary, as the case may be, includes the lending of money and the shares are held or power is exercisable as aforesaid by way of security only for the purposes of a transaction entered into in the ordinary course of that business. (Added 80 of 1974 s. 2)

(7) A reference in this Ordinance to the holding company of a company shall be read as a reference to a company of which that last-mentioned company is a subsidiary. (Added 80 of 1974 s. 2)

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28A Membership of holding company

(1) Subject to the provisions of this section, a body corporate cannot be a member of a company which is its holding company, and any allotment or transfer of shares in a company to its subsidiary shall be void.

(2) Nothing in this section shall apply where the subsidiary is concerned as personal representative, or where it is concerned as trustee, unless the holding company or a subsidiary thereof is beneficially interested under the trust and is not so interested only by way of security for the purposes of a transaction entered into by it in the ordinary course of a business which includes the lending of money.

(3) This section shall not prevent a subsidiary which was, at the commencement* of the Companies (Amendment) Ordinance 1984 (6 of 1984), a member of its holding company, from continuing to be a member.

(4) This section shall not prevent a company which at the date it becomes a subsidiary of another company is a member of that other company, from continuing to be a member.

(5) This section shall not prevent a subsidiary from becoming a member of its holding company, or prevent an allotment to a subsidiary of shares in its holding company, by or by virtue of the exercise by the subsidiary of any rights of conversion attached to any shares in its holding company or under any debentures thereof held by the subsidiary at the commencement* of the Companies (Amendment) Ordinance 1984 (6 of 1984).

(6) This section shall not prevent a subsidiary which is a member of its holding company from accepting and holding further shares in its holding company if such further shares are allotted to it as fully paid up in consequence of a capitalization of reserves or profits by such holding company.

(7) Subject to subsection (2), a subsidiary which is a member of its holding company shall have no right to vote at meetings of the holding company or any class of members thereof.

(8) Subject to subsection (2), this section shall apply in relation to a nominee for a body corporate which is a subsidiary, as if references therein to such a body corporate included references to a nominee for it.

(9) Where a holding company makes an offer of shares to its members it may sell, on behalf of a subsidiary, any such shares which the subsidiary could, but for this section, have taken by virtue of shares already held by it in the holding company, and pay the proceeds of the sale to the subsidiary.

(10) In relation to a company limited by guarantee or unlimited which is a holding company, the reference in this section to shares, whether or not it has a share capital, shall be construed as including a reference to the interest of its members as such, whatever the form of that interest.
(Added 6 of 1984 s. 17)

49A Financing etc. of redemption

(1) Subject to subsection (2) and to sections 49I and 49P(4)-

(a) redeemable shares may only be redeemed out of distributable profits of the company or out of the proceeds of a fresh issue of shares made for the purposes of the redemption; and

(b) any premium payable on redemption shall be paid out of distributable profits of the company.

(2) If the redeemable shares were issued at a premium, any premium payable on their redemption may be paid out of the proceeds of a fresh issue of shares made for the purposes of the redemption, up to an amount equal to-

(a) the aggregate of the premiums received by the company on the issue of the shares redeemed; or

(b) the current amount of the company's share premium account (including any sum transferred to that account in respect of premiums on the new shares),

whichever is the less; and in that case the amount of the company's share premium account shall be reduced by a sum corresponding (or by sums in the aggregate corresponding) to the amount of any payment made by virtue of this subsection out of the proceeds of the issue of the new shares.

(3) Subject to sections 49 to 49S, redemption of shares may be effected on such terms and in such manner as may be provided by the company's articles.

(4) Shares redeemed under this section shall be treated as cancelled on redemption, and the amount of the company's issued share capital shall be diminished by the nominal value of those shares accordingly; but the redemption of shares by a company is not to be taken as reducing the amount of the company's authorized share capital.

(5) Without prejudice to subsection (4) and subject to subsection (6), where a company is about to redeem shares, it has power to issue shares up to the nominal value of the shares to be redeemed as if those shares had never been issued.

(6) Where new shares are issued before the redemption of existing shares, the new shares shall be deemed, so far as relates to the Eighth Schedule, not to have been issued under subsection (5) unless the existing shares are redeemed within 1 month of the issue of the new shares.

49B Power of company to purchase own shares

(1) Subject to sections 49, 49A, 49BA, 49C, 49E, 49F, 49G, 49H, 49P, 49Q, 49R and 49S, a listed company may, if authorized to do so by its articles, purchase its own shares (including any redeemable shares).

(2) Subject to sections 49 to 49S, an unlisted company limited by shares or limited by guarantee and having a share capital may, if authorized to do so by its articles, purchase its own shares (including any redeemable shares).

(3) Sections 49 and 49A apply to the purchase by a company under this section of its own shares as they apply to the redemption of redeemable shares, save that the terms and manner of purchase need not be determined by the articles as required by section 49A(3).

(4) Notwithstanding subsections (1) and (2) but subject to sections 49, 49A, 49F, 49G, 49H, 49I(4) and (5), 49P, 49Q, 49R and 49S, except that such purchases may be made either out of or otherwise than out of its distributable profits or the proceeds of a fresh issue of shares, a listed company and an unlisted company limited by shares or limited by guarantee and having a share capital may, if

authorized to do so by its articles, purchase its own shares (including any redeemable shares) in order to-
(a) settle or compromise a debt or claim;
(b) eliminate a fractional share or fractional entitlement or in the case of a listed company, an odd lot of shares;
(c) fulfil an agreement in which the company has an option or is obliged to purchase shares under an employee share scheme which had previously been approved by the company in general meeting; or
(d) comply with an order of the court under section 8(4), 47G(5) or 168A(2). (Amended 13 of 1995 s. 2)

(5) In subsection (4)(b), an "odd lot of shares" (碎股) means a number of shares in the company less than the usual number authorized for trading on a recognized stock market. (Amended 5 of 2002 s. 407)

(6) A company may not under this section purchase its shares if as a result of the purchase there would no longer be any member of the company holding shares other than redeemable shares.

107 Annual return to be made by company
(1) Subject to this section and section 109, every company shall once in every year make a return, in the specified form, which shall contain, with respect to the company, such particulars as specified therein. (Amended 80 of 1997 s. 102)

(2) Without prejudice to the generality of subsection (1), a return under that subsection shall state-
(a) the company name, its registered number and business name (if any);
(b) the type of company;
(c) the address of the registered office of the company;
(d) the date of the return;
(e) particulars of the total amount of the indebtedness of the company in respect of all mortgages and charges which are required to be registered with the Registrar under this Ordinance, or which would have been required so to be registered if created after 1 January 1912;
(f) in the case of a company having a share capital-
(i) particulars relating to members and share capital of the company; and
(ii) where the company has converted any of its shares into stock and given notice of it to the Registrar, the amount of stock held by each of the existing members;
(g) in the case of a company not having a share capital, except in the case of a company registered with an unlimited number of members, the number of members of the company;
(h) in a case in which the register of members is, under the provisions of this Ordinance, kept elsewhere than at the registered office, the address of the place where it is kept;
(i) all such particulars with respect to the persons who at the date of the return are the directors of the company and any person who at that date is the secretary of the company or a reserve director of the company as are by this Ordinance required to be contained with respect to them in the register of directors and secretaries of a company; (Amended 28 of 2003 s. 42)
(j) if any register of holders of debentures or any duplicate of any such register or part of any such register is, under the provisions of this Ordinance, kept elsewhere than at the registered office of the company, the address of the place where it is kept.

(3) A company (not being a private company having a share capital) need not make a return under subsection (1) in the year of its incorporation or, if it is not required by section 111 to hold an annual general meeting during the following year, in that

year. (Replaced 46 of 2000 s. 9)

(3A) A private company having a share capital need not make a return under subsection (1) in the year of its incorporation. (Added 46 of 2000 s. 9)

(3B) A private company having a share capital which was incorporated in any of the months from July to December inclusive in the year immediately preceding the year in which section 9 of the Companies (Amendment) Ordinance 2000 (46 of 2000) commenced need not make a return under subsection (1) in the year immediately following the year of its incorporation. (Added 46 of 2000 s. 9)

(4) In the case of a company which keeps a branch register, the particulars of the entries in that register shall, so far as they relate to matters which are required to be contained in the return, be included in the return made next after copies of those entries are received at the registered office of the company.

(5) In the case of a company having a share capital if there has been no change in the matters required to be contained in a return, since the date of the last return, the company may in lieu of the return required by subsection (1), make a return by certificate in the specified form, signed by a director or the secretary of the company stating- (Amended 46 of 2000 s. 9)
(a) the date at which the last return under subsection (1) was made up; and
(b) that, as at the day of the annual general meeting for the year there has been no change since that date, in the information contained in that return.

(6) In the case of a private company having a share capital subsection (5)(b) shall be read as if "the most recent anniversary of the date of incorporation of the company" were substituted for "the annual general meeting for the year".

(7) Without affecting the generality of section 2A, the Registrar may, for the purposes of this section, specify different forms or particulars in relation to companies having a share capital, companies not having a share capital or companies which are private companies.
(Added 3 of 1997 s. 31)

123 General provisions as to contents and form of accounts
(1) Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.

(2) A company's balance sheet and profit and loss account shall comply with the requirements of the Tenth Schedule, so far as applicable thereto.

(3) Save as expressly provided in the following provisions of this section or in Part III of the Tenth Schedule, the requirements of subsection (2) and the said Schedule shall be without prejudice either to the general requirements of subsection (1) or to any other requirements of this Ordinance.

(4) The Financial Secretary may, on the application or with the consent of a company's directors, modify in relation to that company any of the requirements of this Ordinance as to the matters to be stated in a company's balance sheet or profit and loss account (except the requirements of subsection (1)) for the purpose of adapting them to the circumstances of the company.

(5) Subsections (1) and (2) shall not apply to a company's profit and loss account if-
(a) the company has subsidiaries; and

(b) the profit and loss account is framed as a consolidated profit and loss account dealing with all or any of the company's subsidiaries as well as the company and-
(i) complies with the requirements of this Ordinance relating to consolidated profit and loss accounts; and
(ii) shows how much of the consolidated profit or loss for the financial year is dealt with in the accounts of the company.

(6) If any person being a director of a company fails to take all reasonable steps to secure compliance as respects any accounts laid before the company in general meeting with the provisions of this section and with the other requirements of this Ordinance as to the matters to be stated in accounts, he shall, in respect of each offence, be liable to imprisonment and a fine: (Amended 7 of 1990 s. 2)
Provided that-
(a) in any proceedings against a person in respect of an offence under this section, it shall be a defence to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that the said provisions or the said other requirements, as the case may be, were complied with and was in a position to discharge that duty; and
(b) a person shall not be sentenced to imprisonment for any such offence unless, in the opinion of the court dealing with the case, the offence was committed wilfully.

(7) For the purposes of this section and the following provisions of this Ordinance, except where the context otherwise requires,-
(a) any reference to a balance sheet or profit and loss account shall include any notes thereon or document annexed thereto giving information which is required by this Ordinance and is thereby allowed to be so given; and
(b) any reference to a profit and loss account shall be taken, in the case of a company not trading for profit, as referring to its income and expenditure account, and references to profit or to loss and, if the company has subsidiaries, references to a consolidated profit and loss account shall be construed accordingly.
(Replaced 80 of 1974 s. 12)

Annex C
(English version only)

Sample Group Accounts Provided by the Hong Kong Institute of Certified Public Accountants

Background

At the Bills Committee on Companies (Amendment) Bill 2004 sixth meeting (held on 15 March 2005), the Administration was requested to provide a paper to address the following:

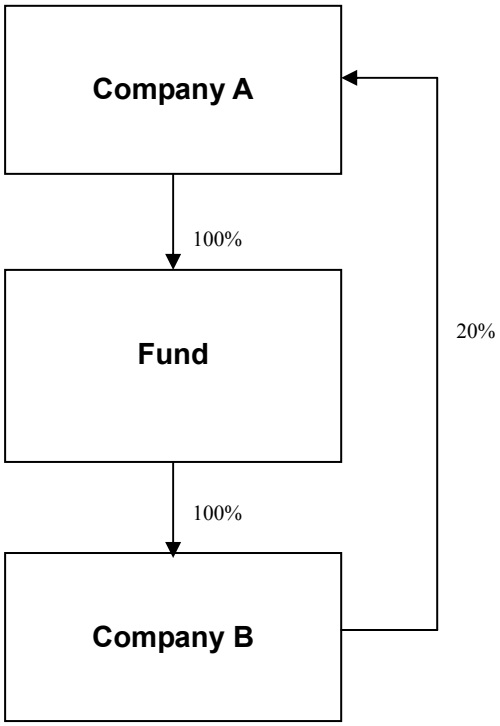
> *In a situation where a company ("A") invests in a fund, which holds shares in another company ("B"), which in turn holds shares in "A", please explain with the relevant provisions and/or accounting rules:*
> - *How any parent and subsidiary relationship between the entities is determined;*
> - *How the group accounts of the entities are prepared;*
> - *Whether section 3(3) is applicable.*

In this regard, the Administration requests the Hong Kong Institute of Certified Public Accountants (Institute) to produce sample group accounts to illustrate how the group accounts of the entities described above are prepared. This paper is prepared by the Institute for that purpose.

Analysis

The above situation would result in group accounts of Company A being prepared only if a parent and subsidiary relationship exists among Company A, the fund and Company B. For illustrative purposes, we assume the group structure is as follows:

Group Structure



Assumptions

In presenting the sample group accounts in a group structure as discussed above, the following assumptions have been made:

- The group structure is legally viable and the cross-shareholding is not in breach of any Hong Kong law.
- The group structure does not result from transactions between entities under common control and thus the group accounts of the group are prepared using the purchase method of accounting.
- The percentage voting rights shown in the group structure indicates the extent of control of an entity over another entity.
- All entities in the group were set up at the same time and thus no goodwill arises on consolidation.
- There are no inter-group transactions except for the cross shareholding.

Individual financial statements

Individual income statements

	Company A	Fund	Company B
	$	$	$
Revenue	100	20	50
Profit before tax	35	10	27
Income tax expense	(6)	(2)	(4)
Profit for the year	29	8	23

Individual balance sheets

	Company A	Fund	Company B
	$	$	$
Assets			
Cash	39	18	50
Investment(s)	1	10	4
Receivables	60	12	30
	100	40	84
Liabilities	(20)	(18)	(30)
Net Assets	80	22	54
Capital and Equity			
Share Capital / Fund Capital	20	1	10
Retained Earnings	60	21	44
	80	22	54

Notes:

1. Company A's investment represents the 100% investment in the Fund
2. Fund's investment represents the 100% investment in Company B
3. Company B's investment ($4) represents the 20% investment in Company A

Group accounts of Company A

In the group accounts of Company A, 100% of the Fund and Company B are included. The shares of Company A that are held by Company B are deducted from the equity of the Group.

Consolidated income statement of Company A

	Group $
Revenue (100+20+50)	170
Profit before tax (35+10+27)	72
Income tax expense (6+2+4)	(12)
Profit for the year	60

Consolidated balance sheet of Company A

	$
Assets	
Cash (39+18+50)	107
Receivables (60+12+30)	102
	209
Liabilities (20+18+30)	(68)
	141
Capital and Equity	
Share Capital	20
Own shares held (20x20%)	(4)
Retained Earnings	125
	141

Notes to the financial statements of Company A:

1. Basis of presentation

   In preparing group accounts, Accounting Standards require entities to look through from ultimate parent to ultimate subsidiaries for consolidation purposes. Accordingly, in the group accounts of Company A, both the financial statements of the Fund and Company B are consolidated.

2. Investment in subsidiary

	Company A $	Group $
Investment in the Fund	1	-

3. Equity

   20% of the share capital of Company A is held by Company B, a subsidiary of Company A. Accordingly, in accordance with paragraph 33 of HKAS 32 *Financial Instruments: Disclosure and Presentation*, the shareholding of Company A held by Company B is deducted from the equity of the Group. This treatment arises purely on accounting and the shareholding of Company A held by Company B has no bearing on determining whether Company A is a parent of the Fund or not.