Companies (Amendment) Bill 1999

The Hong Kong Institute of Company Secretaries supports regulatory changes which are consistent with international standards and appropriate for Hong Kong, and therefore supports the Companies (Amendment) Bill 1999 in general.

Concerns and recommendations are limited to the proposed deregistration provisions.

Although the proposed amendments are generally consistent with relevant standards and appropriate for the local environment, as well as being consistent with relevant Institute views,[1] it is submitted that the proposed deregistration provisions need not include the IRD clearance requirement.

While we welcome the introduction of an alternative avenue to dissolution without liquidation in appropriate circumstances, and the proposed provisions therefor in general, we feel the IRD clearance requirement would protract the process of deregistration without justifiable need or offsetting benefit, as the provisions in place and proposed for the protection of affected persons are adequate, if enforced with vigilance.

IRD clearance for Deregistration

While we appreciate the need to limit the avenues to dissolution without liquidation and access thereto, and the need for appropriate safeguards, we question the need and cost/benefit of the proposed requirement s291AA(3)(b) that an application:

> **'must be accompanied by a written notice from the Commissioner of Inland Revenue stating that the Commissioner has no objection to the company being deregistered.'**

It is submitted that existing and proposed safeguards, that are and would be in effect before, during and after deregistration, are sufficient to protect the interests of creditors and affected persons, the Registrar of Companies and the IRD, and the business environment.

<u>Safeguards Existing</u>

1. Common Law

Action may be taken against directors, corporate officers and members of companies after dissolution for criminal and civil liability, eg. criminal action for fraud; civil action for repayment of costs incurred by company where corporate veil is pierced.

[1] The proposal is consistent with the Institute proposed simplified procedures for liquidation and dissolution which have the support of the LRC Sub-committee on Insolvency as they provide for the satisfaction of claims and the proper dissolution of companies. See Law Reform Commission of Hong Kong Sub-committee on Insolvency Consultation Paper on The Winding-Up Provisions of the Companies Ordinance (April 1998) paras 12.28-12.38.

2. Relevant Statutory Provisions

The Inland Revenue Ordinance (IRO) requires that records of income and expenditure sufficient to enable tax liability to be assessed must be kept and retained for 7-years (s51C(1)). Although dissolution exempts taxpayers from this record keeping requirement, a company dissolved with outstanding tax or other liabilities, may be reinstated under the Companies Ordinance (s290), and the obligation thereby revived. Where records are not properly kept, and without reasonable excuse,[2] one may be liable for an offence under the IRO (s80(1A)) and for tax evasion.[3]

Safeguards Proposed

1. Scope limited to defunct private companies (s291AA(2))

In accordance with proposed provisions, this avenue to deregistration would only be available to certain companies where:

- **'all the members of the company agree to the deregistration;**
- **the company has never commenced business or operation, or has ceased to carry on business or ceased operation for more than 3 months immediately before the application; and**
- **the company has no outstanding liabilities.'**

2. Registrar may ask for additional information (s291AA(5))

> **'The applicant must give the Registrar any <u>further information</u> that the Registrar may request in connection with the application.'**

3. Gazetting of Notice (s291AA(7-8))

> **'If the Registrar is not aware of a failure to comply with any requirements under [s291AA] subsections (2) to (5), the Registrar must publish a notice of the proposed deregistration in the Gazette.'**
>
> **'The notice must state that unless an objection is received within 3 months after the date of publication of the notice, the Registrar <u>may deregister</u> the company and dissolve it.'**

4. Discretionary power, ie. Registrar may strike (s291AA(9))

> **'At the end of that 3 months, if the Registrar has not received any objection to the deregistration, the Registrar <u>may deregister</u> the company by publishing another notice in the Gazette declaring it to be deregistered upon the date of publication of the notice.'**

5. Liability survives dissolution (s291AA(12))

> **'Despite [s291AA] subsection 11 [that companies are dissolved on deregistration], the liability (if any) of the officers and members of the company is to continue and may be enforced as if the company had not been dissolved.'**

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[2] Hong Kong Tax Manual (CCH) para 38-200

[3] The Queen v Radofin Electronics (Far East Ltd) & Anor 1982, 1 HKTC 1252

6. Court Intervention is possible (s291AA(13))

> **'This section does not affect the power of the court to wind up a deregistered company.'**

7. Offence for Provision of false/misleading Information (s291AA(14))

> **'A person who, in connection with an application made under this section, knowingly or recklessly gives any information to the Registrar that is false or misleading in a material particular is liable to a fine and to imprisonment.'**

8. Exclusion of companies, ie. scope may be further limited (s291AA(16))

> **'This section does not apply to a company specified in the Sixteenth Schedule as a company to which this section does not apply.'**

9. Reinstatement of Deregistered Company via action of Registrar by publication or otherwise by court order following application (s291AB)

> **'A company reinstated under [s291AA] subsection (1) or (2) is taken to have continued in existence as if it had not been deregistered.'**

10. Records Required to be Kept after dissolution (s292(3))

> **'A person who was a director of a company immediately before its dissolution must ensure that all the books and papers[4] of the company are kept for not less than 5 years after the dissolution.'**

Empirical Evidence of Need

Although we appreciate that IRD clearance may expedite processing at the Companies Registry and otherwise provide the Registry with a significant assurance, and the IRD with a preference, there would appear to be little empirical evidence of the need for the proposed provision.

In the case of the IRD, the Commission has indicated that in most cases, they are not overly concerned with dissolution of companies with tax liabilities, as, in the rare case where a company has been dissolved with outstanding or potential tax liabilities, the IRD could rely on the Companies Ordinance to reinstate (s290).[5]

[4] See recommendations below.

[5] LRC Sub-committee on Insolvency Consultation Paper on The Winding-Up Provisions of the Companies Ordinance (April 1998) para 12.35.

Evidence of the lack of a need for IRD clearance in the proposed procedure is implicit in its absence from relevant existing Companies Ordinance provisions for:

1. **<u>liquidation and dissolution</u>, *which do not require* that liquidators obtain IRD tax clearance prior to winding-up the affairs of a company,[6] and**

2. **<u>dissolution without going through the process of liquidation</u>, *which do not require* IRD tax clearance, ie:**

a) Application to Registrar of Companies to exercise power under section 291 where company has not engaged in business since formation, has been dormant in excess of one-year, and has no assets or outstanding liabilities.
b) Action by the Registrar of Companies where he has reasonable cause to believe that a company has not and is not carrying on operations (s291); or where company has not filed an annual return for 2 consecutive years without excuse (s290A).
c) Court Order on application of the Registrar of Companies where he feels liquidation would be inappropriate (even where company is still in possession of assets; s291A).
d) Court order pursuant to statutory scheme of reconstruction or merger (s167).
e) Government Order pursuant to recommendation of Chief Executive in Council that the Registrar of Companies strike off a company engaging in 'undesirable activities' (s360C).

<u>Recommendations</u>

1. **That proposed section 291AA(3)(b) be deleted from the Bill.**
2. **That proposed section 292(3) be amended as follows: 'A person who was a director of a company immediately before its dissolution must ensure that all the books and *records of the company required to be kept by the Companies Ordinance* are kept for not less than 5 years after the dissolution.'**

<u>Alternatives</u>

Should it be deemed necessary to fortify the proposed safeguards upon deletion of the IRD requirement, perhaps the following might be appropriate:

1. disclosure provisions might be extended, eg. perhaps a longer period of notice, imposition of daily newspaper exposure (costs might be cut via dedication of notice board space in the news or otherwise, eg. Companies Registry web page);
2. cessation of business requirements might be extended beyond 3-months (s291AA(2)); and/or
3. requirement that records be kept might be extended and perhaps brought in line with the relevant IRD records period, ie. 7-years (s292(3)).

[6] Ibid, para 12.34.

Concluding Remarks

It must be remembered that the proposed provisions for dissolution are not being put forward as alternatives to the liquidation process which ends in dissolution, but as alternatives to the provisions for deregistration, ie. for dissolution without liquidation.

As the primary objective of the proposed provisions for deregistration is presumably to get companies off the register via an avenue other than those provided by sections 291 or 290A, which have been somewhat misused in practice, the IRD requirement would appear to be an unnecessary and perhaps unduly bureaucratic step which may only serve to protract the process without significantly increasing the protection available to affected persons.

We feel the safeguards proposed in the Bill are broad in scope and sufficient to address the interests of affected persons, regulators and the business environment, with the most significant being that liability will survive the dissolution, companies may be reinstated with relative ease, and the discretionary power of the Registrar of Companies regarding the approval of dissolution applications and the information required of applicants - which would allow for the production of tax and other clearances as necessary.

It is also submitted that the cost of compliance with the proposed IRD clearance requirement in terms of time, effort and money would outweigh the likely benefits. There is little doubt that the time required to obtain a clearance as proposed will be significant and may be substantial. In addition to the cost of compliance to applicants, the proposed procedure may also result in significant costs and delays at both the Companies Registry and the IRD.

Given the limited access to the proposed route to dissolution, the safeguards otherwise proposed, and the cost of compliance versus likely benefits, the rationale for the IRD clearance requirement seems insufficiently great to justify its inclusion in the Bill.

Thank you again for the opportunity to comment on the Bill. Should the Bills Committee like to discuss any of the points in this submission prior to the meeting on 20 April, please do not hesitate to call me directly.

Kind regards,

Peter Tashjian
Chief Executive