Asia Pacific Guide to Lending and Taking Security - Hong Kong SAR

When considering whether to lend

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# 1. Is it necessary or advisable for any lender, arranger, facility agent or security agent to be licensed, qualified or otherwise entitled to carry on business in this jurisdiction: (a) by reason only of its execution, delivery or performance of the finance documents; or (b) to enable it to enforce its rights under the finance documents?

A lender, arranger, facility agent or security agent ("**Finance Party"**) that is a party to any loan or security arrangements with a company located in Hong Kong is generally not subject to any licensing requirements provided it is an “authorized institution” (AI) under the Banking Ordinance (BO). There are three types of AI, namely, licensed banks, restricted license banks and deposit-taking companies.

If a Finance Party is not an AI, but intends to lend money in Hong Kong (e.g., whether to a Hong Kong company or other legal person, or if the loan is advanced in Hong Kong), then the Money Lenders Ordinance (MLO) imposes licensing and other compliance requirements that may apply to a non-AI lender. The MLO requires any lender (other than an AI) that is in the business of making loans in Hong Kong (or who advertises, announces or holds themselves out as doing so) to obtain a money lenders’ license and to comply with various requirements relating to the making of loans.

Exemptions from the MLO licensing requirements and most of the MLO compliance requirements (other than in relation to restrictions on charging excessive interest rates) are available, namely, in respect of “exempted persons” and “exempted loans” (as specified in Schedule 1 of the MLO).

Exempted persons include banks incorporated or established outside Hong Kong that are considered by the Hong Kong Monetary Authority (HKMA) (pursuant to a declaration to be obtained from the HKMA on a case-by-case basis) to be subject to prudential supervision by a recognized banking supervisory authority.

Exempted loans include, amongst other, loans made to any of the following persons:

A company where the loan is secured by a mortgage, charge, lien or other encumbrance that is registered under the Companies Ordinance (CO).

A company that has a paid-up share capital of not less than HKD 1,000,000 (or an equivalent amount in any other approved currency which is freely convertible into Hong Kong dollars).

A company the shares or debentures of which are listed on a recognized stock market (or any subsidiary of that company).

Securities margin financing-related activities may be regulated separately by, or require compliance with, Guidelines, Codes or Rules published or overseen by the Securities and Futures Commission (SFC). This may include (except in the case of an AI lender for which an exemption may be available) a requirement for licensing by the SFC.

# 2. Will any lender, arranger, facility agent or security agent be deemed to be resident, domiciled, carrying on business or subject to tax by reason only of the execution, delivery, performance or enforcement of the finance documents?

**Carrying on business**
The execution, delivery and enforcement of loan or security documents in Hong Kong do not, of themselves, usually lead to the conclusion that a Finance Party is carrying on business in Hong Kong, nor would those acts generally result in a Finance Party being deemed to be resident or domiciled in Hong Kong. However, the performance by a Finance Party of its obligations under a loan or security document in Hong Kong might suggest that the relevant person is carrying on business in Hong Kong. For example, where the facility agent function is carried out through an office or branch in Hong Kong or the loan is arranged through employees operating in Hong Kong.

**Residence**
Residence is usually determined in the first instance by the place of incorporation. However, a company may be resident in a particular place, even though it is not incorporated there, if its central management and control is exercised there. As the tax system in Hong Kong does not adopt a residence basis of taxation, residence is generally not relevant in the context of determining a company’s tax liability in Hong Kong.

**Domicile**
Domicile is not relevant for tax purposes in Hong Kong.

**Tax**
Hong Kong profits tax is territorial in nature and only profits which have, or which are deemed to have, a Hong Kong source are subject to profits tax. To be liable to profits tax:

A person must carry on a trade, profession or business in Hong Kong

The person must derive profits from that trade, profession or business, other than profits arising from the sale of capital assets

Those profits must arise in, or be derived from, Hong Kong

Whether interest or fees arise from the carrying on of a business in Hong Kong will be a question of fact to be determined based on all the circumstances in each case. If operations of substance relating to a transaction are carried out in Hong Kong, the relevant person would be regarded as carrying on business in Hong Kong.

The Hong Kong Inland Revenue Department and the Hong Kong courts have tended to the view that the threshold test for whether a person is carrying on business in Hong Kong is low. Ultimately, whether this is the case is a question of fact, and it is necessary to take into consideration all the activities of the Finance Party.

If in doubt, it is possible to obtain an advance ruling from the Hong Kong Inland Revenue Department (IRD) in relation to a specific arrangement or transaction. The ruling granted is only binding on the taxpayer applicant in relation to that particular transaction for the specified period provided the facts set out in the ruling are complete and remain correct. The IRD has a standard timeframe of up to six weeks (as noted in the Departmental Interpretation and Practice Notes No. 31 Advance Rulings as revised in April 2020) for processing any advance ruling application provided that all relevant information has been furnished. This timeframe can be extended for another six weeks if additional information is required. However, in more complex cases, a longer review period may be required by the IRD. The advance ruling mechanism is not available for stamp duty issues.

# 3. Are there any regulatory reporting requirements that lenders must observe in connection with those transactions?

To comply with the BO, if an institution is an AI (see the answer to question 1 of this section), it is generally required to submit periodic reports to the HKMA, including periodic reporting in relation to its assets, provisions and capital adequacy.

In addition, if a Finance Party carries on business in Hong Kong (see the answer to question 2 of this section), it must generally file annual profits tax returns that disclose specified information about the business. The financial accounts and a number of supporting documents must accompany the returns. The IRD can request any person to provide further information relevant for administering tax law. The IRD regularly uses this power to request further information and documents from taxpayers to assist it with its tax assessment.

# 4. Is it necessary to establish a place of business in your jurisdiction in order to enforce any provision of the finance documents?

No. Please also refer to the answer to question 1 of this section in respect of the applicable licensing requirements.

# 5. Is a foreign bank/financial institution permitted to approach local entities for business?

A foreign bank or financial institution that is an AI or a licensed money lender or that can avail itself of an exemption from the MLO may approach local entities for lending business. Please also refer to the answer to question 1 of this section in respect of the applicable licensing requirements, which also apply to foreign banks and financial institutions. In addition, approaching local entities for business may support the view that a foreign bank or financial institution carries on business in Hong Kong (please refer to our discussion in the answer to question 2 of this section).

In the case of a Hong Kong-incorporated AI, various lending restrictions may apply. For example, the BO provides for connected party lending limits (e.g., advances to directors and their relatives, certain controllers of the AI and employees who handle credit approvals for an AI and those employees' relatives), as well as large exposure limits (i.e., limits on the financial exposure of an AI to any single counterparty or any group of related counterparties).

Foreign banks and financial institutions that establish, with HKMA approval, a local representative office in Hong Kong are generally subject to strict restrictions in relation to the activities that their local representative office may conduct. These restrictions are generally imposed by way of conditions that the HKMA includes in its approval letter. Representative offices are generally prohibited from carrying out anything other than limited marketing, liaison or representational activities.

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