

Lending to a Company in Hong Kong: Structuring the Transaction

by **Victor Sim**, **Etelka Bogardi**, and **Daniel Ng**, Norton Rose Fulbright Hong Kong.

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A Practice Note looking at the key considerations involved in structuring a loan to a company incorporated or located in Hong Kong (which may also involve a guarantor or security provider incorporated or located in, or assets located in, Hong Kong), where the lender is incorporated in another jurisdiction.

It looks at considerations such as tax, costs, and regulatory issues, and issues that can affect taking security and guarantees.

Lawyers advising a lender who is proposing to make a loan to a borrower incorporated or doing business in another jurisdiction need to be aware of a variety of issues that can affect the structure of the loan transaction. In addition, if a transaction also involves a guarantor or security provider incorporated or doing business in another jurisdiction, or the assets over which security is being taken are located in another jurisdiction, then there will be other issues to consider.

It is important to identify these issues in the early stages of structuring a transaction, as they can have an impact on key elements of the transaction structure, such as:

- Who the borrower, guarantor, and security providers will be.
- Whether taking guarantees and types of security will be feasible in light of the costs involved.
- The lender's ability to enforce security interests and guarantees.
- The lender's rights in an insolvency of the borrower or other obligors.

This Note looks at the following issues which may affect the structure of a transaction:

- Tax considerations and implications, including withholding taxes, documentary taxes, and other types of taxes that may affect a lender or borrower.
- Costs affecting the transaction, including registration fees, notaries' fees, and any other similar costs imposed on the transaction.
- Issues involved in taking a guarantee or security.
- Issues involved in enforcing a loan, guarantee, or security interest.
- Lenders' rights in an insolvency of a borrower, guarantor, or security provider.
- Regulatory issues affecting foreign lenders, including licensing or registration requirements in Hong Kong applicable to foreign lenders making commercial loans to a borrower in Hong Kong.

Tax Implications

The taxes applicable to a loan transaction with a borrower who is incorporated in, or doing business in, a different jurisdiction from the jurisdiction where the lender is incorporated or doing business may have a significant impact on the transaction and whether it is feasible.

Withholding Taxes

Hong Kong does not impose a withholding tax on payments of interest to foreign lenders.

Documentary Taxes

In Hong Kong, stamp duties and other documentary taxes generally are not applicable to loan agreements, guarantees, or security documents.

Costs Affecting a Transaction

Registration Fees

Generally, no registration fees are payable to a governmental authority on the granting or enforcement of a loan facility, guarantee or security interest. However, certain types of security interests must be registered with the Hong Kong Companies Registry (*section 335, Companies Ordinance (Cap. 622)*). A fee applies to the filing of the registration of such security interests with the Hong Kong Companies Registry, and the amount of the filing fee is HKD340.

Mortgages of real property (including land and buildings) need to be registered in the Land Registry, which requires payment of a registration fee in the amount of HKD230 or HKD450, depending on the value of the obligations secured by the mortgage.

Security instruments covering intellectual property require payment of the following registration fees, depending on the type of asset concerned:

- The Designs Registry, a fee of HKD590.
- The Patents Registry, a fee of HKD325.
- The Registrar of Trade Marks, a fee of HKD800.

Notaries' Fees

As notarisation is generally not required, notaries' fees are not applicable to the granting or execution of loan agreements, guarantees and security documents.

Issues in Taking a Guarantee or Security

Assuming that a foreign lender is not required to have a money lender's licence to make a loan to a Hong Kong company, there are no specific restrictions on that foreign lender's ability to take a guarantee or security from a Hong Kong company or a security interest over assets located in Hong Kong (see [Practice Note, Lending to a Company in Hong Kong: Regulatory Issues: Restrictions on Taking Security or a Guarantee](#)). There are, however, other general laws and issues that can affect the ability of any lender to take or enforce guarantees and security. These include matters relating to corporate benefit, financial assistance for the acquisition of shares, and security for loans to directors. A lender taking security may also need to be aware of the risk of environmental liability.

Corporate Benefit for a Guarantor or Security Provider

A Hong Kong company has the same capacity and power to give a guarantee as a natural person of full age (*section 115, Companies Ordinance*). However, when exercising the company's power to give a guarantee, its directors have a fiduciary duty to act in the best interests of the company. In particular, when deciding whether a company should give an upstream or cross-stream guarantee or security, the directors will have to consider whether such an act is in the best interests of the company, and whether the company derives any corporate benefit from it. In case of doubt, it may be prudent to obtain shareholders' approval in respect of the relevant transaction. (For further information relating to corporate benefit, see [Practice Note, Lending to a Company in Hong Kong: Legal and Documentation Issues: Corporate Benefit](#).)

Financial Assistance

A Hong Kong company is prohibited from providing financial assistance for the purpose of acquiring its own shares or the shares of its Hong Kong parent company before or at the same time as the acquisition takes place (*section 275, Companies Ordinance*). This prohibition is subject to various exceptions, as provided in sections 277 to 281 of the Companies Ordinance, which include (but not limited to) the following:

- Section 278 of the Companies Ordinance provides that a company can give financial assistance if both:
 - the principal purpose of the assistance is (i) not the acquisition of a share in the company or its holding company, or (ii) the giving of assistance is only an incidental part of some larger purpose of the company; and
 - the assistance is given in good faith in the interests of the company.
- A Hong Kong company can also overcome this prohibition by meeting the solvency test and complying with certain authorisation procedures, as described in sections 283 to 285 of the Companies Ordinance.

Contracts connected to prohibited financial assistance are not invalidated merely because of contravention of the financial assistance provisions (*section 276, Companies Ordinance*).

Failure to comply with the general prohibition against financial assistance is an offence for which the company and every responsible person may be liable to a fine of HKD150,000 and to imprisonment for a maximum period of 12 months.

For further information, see [Practice Note, Lending to a Company in Hong Kong: Legal and Documentation Issues: Financial Assistance](#).

Loans Made by a Company to Its Directors

A company is generally prohibited from making loans to, or giving guarantees or providing security for loans to, any of its directors, or directors of its holding company or companies controlled by the company's directors or directors of its holding company, without the approval of its shareholders (*section 500, Companies Ordinance*). The Companies Ordinance also generally prohibits public or listed companies from providing quasi-loans and credit transactions to their directors or directors of their holding company. The same prohibition applies to private companies or companies limited by guarantee that are subsidiaries of a public or listed company (*sections 501 and 503, Companies Ordinance*).

Environmental Laws

Generally, a lender does not incur liability by reason of the actions or omissions of a borrower, guarantor or security provider, because the debtor-creditor relationship does not give rise to liability for acts of the other party. However, on the occurrence of an event of default, care must be taken if the security interest is enforced because the lender may be liable as a mortgagee in possession if it takes possession of the assets which are subject to the security, even if the lender did not cause the environmental damage.

In addition, if a lender participates in the management or operations of the borrower (or another obligor providing security) to the extent that it can be regarded as a shadow director of such obligor, the lender may be exposed to liability relating to that obligor's breach of environmental laws.

In practice, loan agreements often include representations, warranties and undertakings (also known as covenants) with the aim of reducing the risk of liability on the part of the lender for environmental claims. For example, the borrower could represent that it has complied with, and undertakes to comply with, all environmental laws, and maintains all requisite environmental permits. The borrower may also be required to undertake that it will promptly inform the lender if there is any environmental claim which has been commenced or is threatened against it. A breach of these representations, warranties or undertakings is likely to constitute an event of default, allowing the lender to demand full repayment of the loan.

Issues in Enforcing a Loan, Guarantee or Security Interest

A statutory power of sale is conferred by the Conveyancing and Property Ordinance (Cap. 219) for a legal charge or equitable mortgage over land in Hong Kong. There are restrictions on when the statutory power of sale is exercisable. The statutory power is not exercisable until one of the following has occurred:

- Notice requiring payment of the mortgage money has been served on the mortgagor, or on one of the several mortgagors and the mortgage money or part of it has not been paid within one month after such service.
- Interest under the mortgage is in arrear and unpaid for one month after becoming due.
- There has been a breach of a provision, either express or under the Conveyancing and Property Ordinance (Cap. 219), of the mortgage other than a covenant for payment of the mortgage money and interest.

Nevertheless, the above restrictions can be varied by express terms in the document.

Other than the above, there is generally no restriction that prohibits lenders from commencing proceedings against a company in Hong Kong or from enforcing security rights in Hong Kong. A lender is generally able to enforce its rights under a loan agreement, guarantee, or security document pursuant to its terms upon the occurrence of an event of default specified in those documents.

For more information, see [Country Q&A, Lending and Taking Security in Hong Kong: Overview: Questions 19 and 20](#).

Lenders' Rights in Insolvency

Winding Up

Legislation governing corporate insolvency is contained principally in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (Companies Winding Up Ordinance) and some of its subsidiary legislation.

There are three types of winding up:

- Members' voluntary winding up (see [Members' Voluntary Winding Up](#)).
- Creditors' voluntary winding up (see [Creditors' Voluntary Winding Up](#)).
- Compulsory winding up (see [Compulsory Winding Up](#)).

A solvent company may be wound up in a members' voluntary winding up. An insolvent company may be wound up in a creditors' voluntary winding up or a compulsory winding up.

Members' Voluntary Winding Up

A members' voluntary winding up commences on the passing of a resolution by the company in general meeting to wind the company up. Among other reasons, a company can be wound up voluntarily by both of the following:

- The directors' issuance of a certificate of solvency expressing their opinion that the company will be able to pay its debts in full within a period not exceeding 12 months after commencement of the winding up.
- A special resolution of the members within 5 weeks after the issuance of the certificate of solvency.

Creditors' Voluntary Winding Up

A creditors' voluntary winding up does not necessarily have to be initiated by the creditors. A creditors' voluntary winding up occurs upon the occurrence of any of the following:

- A shareholders' special resolution to wind up the company has been passed but no certificate of solvency has been issued by the directors.
- A liquidator, in the case of a proposed members' voluntary winding up, is of the opinion that the company will be unable to pay its debts in full within the period stated in the certificate of solvency.
- The directors have:
 - passed a resolution that the company cannot by reason of its liabilities continue its business and they consider it necessary that the company be wound up (in circumstances where it is not reasonably practicable for the winding up to be commenced under any other section of the Companies Winding Up Ordinance); and
 - delivered a winding up statement to the Hong Kong Companies Registry.

- A court orders that a winding up be conducted as a creditors' voluntary winding up on the application of a liquidator or creditor made within three months of:
 - an order made under section 227F of the Companies Winding Up Ordinance; or
 - the meeting of creditors and contributories (that is, those who are liable to contribute to the assets of a company in the event of its being wound up) under section 194 of the Companies Winding Up Ordinance.
 - (*Section 209A, Companies Winding Up Ordinance.*)

Compulsory Winding Up

Compulsory winding up commences upon the presentation of a petition for winding up by (among others) the company, a creditor, or a contributory.

The reasons for a company being wound up by a court include:

- The company cannot pay its debts.
- The court is of the opinion that it is just and equitable that it should be wound up.

In most cases, winding up orders made by a court are on the grounds of inability to pay debts upon petitions made by creditors. The Companies Winding Up Ordinance sets out three ways to prove that a company cannot pay its debts, including failure to pay without reason a sum equal to or exceeding HK\$10,000 within three weeks from the date of a statutory demand.

A winding up order will have retrospective effect and the winding-up of a company will be deemed to have commenced from the date of presentation of a petition for winding-up.

Alternatives to Winding Up for an Insolvent Company

In recent years, there has been growing awareness that recoveries for creditors are likely to be higher if the business can be rescued or restructured rather than closed and assets sold. The options available to an insolvent company are:

- Informal workouts (see [Informal Workouts](#)).
- Schemes of arrangement (see [Schemes of Arrangement](#)).

Informal Workouts

A company may attempt to rescue itself by a workout plan. A workout plan is an informal contractual arrangement for debt restructuring between an insolvent company and all of its creditors. It is not provided for or regulated by statute.

The terms of a workout plan are flexible as it is ultimately a contractual arrangement between the company and its creditors. This may take a number of different forms, such as deferment of time for payment, translation of current debt into equity or long-term loans, and consolidating existing loans to reduce interest payments. The terms of a workout require agreement by all creditors. Once the terms of the arrangement are approved, creditors will have close control over implementation of the arrangement. If successful, a workout plan will rescue the company so that it can avoid being wound up.

Whether a workout plan is viable usually depends on whether a larger pool of wealth can be achieved as compared to the company's immediate liquidation.

Schemes of Arrangement

The Companies Ordinance provides a procedure by which creditors of a company are able to reach an agreement to bind themselves and the company, by a prescribed level of majority, in a composition with creditors (sections 668 to 677 of the Companies Ordinance). If a majority in number representing 75% in value of its creditors (or any class of them) agree to a proposed compromise or arrangement, the compromise or arrangement will, if sanctioned by the court, be binding on all applicable classes of creditors and the company (including a liquidator and the dissenting minority). This compromise or arrangement is called a scheme of arrangement.

The procedure involves three stages:

- **Application to court.** An application to the court must be made for an order to summon one or more meetings of the creditors. The application must be made by the company, any creditor or member, or, in the case of a company which is being wound up, the liquidator or provisional liquidator.
- **Approval of creditors.** The proposals must be put to the meetings of the creditors (or any class of them), considered at the meetings, and approved by a majority in number representing 75% in value of the claims of those present and voting in person or by proxy.
- **Sanction of court.** The proposals are sanctioned by an order of the court.

The court order takes effect when it is delivered to the Registrar of Companies for registration.

Without the scheme of arrangement procedures, unanimous approval of the members or creditors is required if a compromise or arrangement is to be effective. In an insolvency situation the need for unanimity may cause a perfectly reasonable rehabilitation proposal to be defeated by a single dissenting creditor.

Moratoriums

Under Hong Kong law, there is no statutory scheme that imposes an automatic stay or similar moratorium on the enforcement of a lender's claims in the event of the borrower's insolvency. Although it is not uncommon for lenders to attempt to negotiate an informal restructuring agreement with the borrower, any creditor may commence insolvency proceedings against the borrower if that creditor does not agree with the proposed restructuring arrangements of the majority creditors.

However, in recent years, various devices have been used (under the Companies Winding Up Ordinance or otherwise) to achieve an effect equivalent to a moratorium, including:

- In a voluntary winding up, a stay of proceedings can be effected by court on the application of a creditor, contributory, or liquidator.
- In a compulsory liquidation:
 - after the presentation of a winding-up petition but before the issuance of a winding up order, an adjournment or a stay of proceedings can be effected by court on the application of a creditor, contributory, or the company; or

- on issuance of a winding up order or the appointment of a provisional liquidator, an automatic stay will be imposed on all actions and proceedings against the company unless the court grants leave to commence proceedings.
- In a consensual restructuring process, a stay can be effected if all the creditors sign a standstill agreement to prevent any of those creditors from commencing winding up proceedings.
- In a scheme of arrangement, a winding up petition may be adjourned if the court is of the view that a potential scheme of arrangement may be sanctioned.

No "moratorium" described above affects a secured creditor who is entitled to enforce its security. A stay of proceedings will not usually be granted where a secured creditor is seeking to realise its security. This is because the assets which are subject to a security interest belong in equity to the secured creditor since the security document creates a proprietary interest in favour of the secured creditor. The secured assets are therefore not available to meet the claims of the general body of unsecured creditors.

The insolvency of a borrower does not affect a lender's rights against a guarantor or security provider who is not a party to an insolvency proceeding.

Priority of Claims in Insolvency

If the borrower is subject to insolvency proceedings, the order of priority amongst the various types of claimants can be summarised as follows:

- **Secured creditors with a fixed charge or mortgage.** Secured creditors are entitled to enforce their security interests despite the making of a winding-up order against the company by the court. Assuming that the security is properly perfected, priority between creditors secured by fixed charges or mortgages over the same asset generally depends on the order in time in which the fixed charges or mortgages were created. Typically, the security document provides for the appointment of a receiver in the event of liquidation, who is appointed to enforce the security by selling the assets which are the subject to the security. The secured creditors would be paid first out of the sale proceeds of the assets. To the extent that their claims cannot be fully satisfied from the proceeds of the assets which are the subject of the security, the balance of those claims would generally rank *pari passu* with claims of other unsecured creditors.
- **Costs of liquidation.** The costs of liquidation are paid out of assets of the insolvent company before distributions are made to preferential and other creditors.
- **Preferential creditors.** Preferential creditors have priority over the remaining unpaid creditors. Preferential creditors include employees of the insolvent company (subject to certain limits per employee) and statutory debts owed to the government such as taxes and rates.
- **Creditors holding a floating charge.** Creditors holding a floating charge are the next class of creditors entitled to payment out of the assets of the insolvent company. Where there is more than one floating charge, priority generally depends on the order in which the floating charges were created. The fact that the floating charge may have crystallised or that a receiver has been appointed under the document creating the floating charge will not entitle the holders of the charge to rank ahead of any preferential creditors.
- **Unsecured creditors.** The general body of unsecured creditors ranks after creditors holding a floating charge.
- **Shareholders.** The shareholders of the insolvent company receive the remaining proceeds from the insolvency (if any) after all other creditors have been paid in full.

Hong Kong courts will also give effect, notwithstanding a borrower's insolvency, to a subordination agreement or intercreditor agreement which provides for claims of certain creditors to rank ahead of those of other creditors who are parties to the agreement.

For more information, see [Country Q&A, Lending and Taking Security in Hong Kong: Overview: Question 24](#).

Transactions Which May Be Set Aside

At the time of the winding up of a company, the liquidator may be able to set aside certain transactions entered into by the company. The liquidator must obtain a court order for this purpose. The transactions which may be set aside are broadly covered by the Companies Winding Up Ordinance in section 265D (transaction at an undervalue), section 266 (unfair preference), and section 267 (avoidance of floating charge).

- **Transactions at an undervalue.** The court has power to set aside transactions at an undervalue entered into by a company within five years before commencement of its winding up if, at the time of the transaction, the company was unable to pay its debts or if it became unable to pay them as a result of the transaction.

Transactions at an undervalue include gifts or transactions where the company receives no consideration (that is, no benefit) or receives consideration of a value (in money or money's worth) that is significantly less than the consideration provided by the company.

- **Unfair Preferences.** A company gives an unfair preference if it does anything which puts a creditor into a position which, in the event of an insolvent liquidation, will be better than the position that creditor would otherwise have been in. The court has power to set aside an unfair preference transaction (if it is not a transaction at an undervalue) if:
 - it was given to a person who is connected to the company (other than an employee) within two years before commencement of the winding up or given to any other person within six months before commencement of the winding up; or
 - the company was unable to pay its debts at the time of the transaction or it became unable to pay them as a result of the transaction. The court may not make an order unless the company was influenced, in deciding to give the unfair preference, by a desire to prefer the relevant creditor. Transactions involving a connected person are presumed to involve unfair preference unless proven otherwise.

In the case of lending transactions, section 266A(1) of the Companies Winding Up Ordinance provides that a company gives an unfair preference to a person if:

- That person is one of the company's creditors, or a surety or guarantor for any of the company's debts or other liabilities; and
 - The company does anything, or suffers anything to be done, which has the effect of putting that person into a better position than it would have been in had that thing not been done.
- **Avoidance of floating charges.** Except in relation to the categories of consideration specified below, a charge on the undertaking or some or all of the property of the company which was created as a floating charge is invalid if:
 - it was created in favour of a connected person within two years before commencement of the winding up; or
 - it was created in favour of any other person within 12 months before commencement of winding up; and

- the company was unable to pay its debts at the time of the creation of the floating charge or it became unable to pay them as a result of its creation.

The categories of consideration relating to which a floating charge will be valid, if provided at the same time as, or after, the creation of the floating charge, are:

- money paid to the company;
- money paid at the direction of the company;
- property or services supplied to the company; and
- the amount of any interest payable on the amount of the three preceding items at the rate specified in the agreement or 12% per annum, whichever is less.

For more information, see:

- [Country Q&A, Lending and Taking Security in Hong Kong: Overview: Question 23.](#)
- [Country Q&A, Restructuring and Insolvency in Hong Kong: Overview: Question 10.](#)

Regulatory Issues Affecting Foreign Lenders

Making a Loan

For a summary of the regulatory requirements that a foreign lender needs to comply with before it may make a commercial loan to a borrower in Hong Kong, such as licensing, filing and registration requirements, see [Practice Note, Lending to a Company in Hong Kong: Regulatory Issues: Restrictions on Making Loans.](#)

Taking a Guarantee or Security Interest

For a summary of the regulatory requirements that a foreign lender needs to comply with before it can take a guarantee or a security interest from an entity in Hong Kong, or a security interest over assets located in Hong Kong, see [Practice Note, Lending to a Company in Hong Kong: Regulatory Issues: Restrictions on Taking Security or a Guarantee.](#)

Enforcing Rights Under a Loan Agreement

For a summary of the regulatory requirements that a foreign lender needs to comply with before it can enforce its rights under a loan agreement against a borrower in Hong Kong, see [Practice Note, Lending to a Company in Hong Kong: Regulatory Issues: Restrictions on Enforcing Rights Under a Loan Agreement.](#)

Enforcing Security Interests

For a summary of the regulatory requirements that a foreign lender needs to comply with before it can enforce security interests in Hong Kong, see [Practice Note, Lending to a Company in Hong Kong: Regulatory Issues: Restrictions on Enforcing Security.](#)

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