[6-4] There are, however, several exceptions to this rule, whereby a prior authorisation must be obtained. These are outlined below. In sectors deemed 'sensitive' by the French government, foreign investors must obtain prior authorisation and the investment amount is capped to protect national security.

[6-5] Article L151-1 and the following French Monetary and Financial Code outline the national security principles in more detail.

2.1 No prior declaration

[6-6] Decree 2017-932 eliminated the obligation to file an administrative declaration, as part of the movement towards the simplification of French investment procedures to attract and encourage foreign investment into France. However, post-completion statistical declaration still remains mandatory and is outlined below.

[6-7] Foreign investors must file declarations for statistical purposes with the Bank of France within 20 business days following the completion of any of the following transactions, if the transaction exceeds €15 million:

(a) the acquisition of 10% or more of the equity or voting rights in a French resident company or where the foreign investor's equity or voting rights in the French resident company rises above a 10% threshold as well as any transaction between related companies, including loans, deposits or real estate investments; or
(b) the acquisition or sale of real estate in France by a non-resident.

2.2 Prior authorisation required in limited instances

[6-8] Prior authorisation may be required in certain sectors. These sectors are deemed by the French government as being 'sensitive' sectors and therefore will require authorisation to protect national security interests. They are divided between EU and non-EU foreign investors, as listed below.

2.2.1 Investments from EU Member States

[6-9] These include: private security services, interests concerning the prevention of illicit use of biological or toxic agents or other agents prohibited in the construction of chemical weapons, equipment designed to intercept communications, the evaluation and certification of systems used in information technology, the production of goods or provision of services relating to the security of information systems, goods and technology with dual applications.

[6-10] A Decree dated 14 May 2014 extended this list to include foreign investments made in activities related to the integrity, safety and continuity of (a) the supply of water, electricity, gas, hydrocarbons and any other source of energy; and (b) the operation of transport services and telecommunications, as well as foreign investments made in activities related to 'the protection of public health'.

2.2.2 Investments from non-EU countries

[6-11] This pertains to the sectors outlined above, including the sectors targeted by the Decree dated 14 May 2014, plus: gambling (excluding casinos), encryption and decryption systems for digital applications, businesses certified for national defense, trade in weapons, munitions and explosives for military applications or equipment used in warfare, and businesses under contract to supply research or equipment to the French Ministry of Defense or its subcontractors.

[6-12] The thresholds triggering prior authorisation requirements are:

(a) Any foreign investor, whether EU or non-EU investors, in the acquisition of a controlling interest, a majority of votes, in a French company or the acquisition of all or part of a business line; and
(b) Foreign investors outside the EU in the acquisition of interests exceeding 33.33% of equity or voting rights in a French company.

2.3 Formalities and sanctions related to the authorisation request

2.3.1 Formalities

[6-13] If the investment thresholds outlined above are met, the foreign investor will have to notify the French Treasury Department. This request must be filed before the foreign investment is made, and it must provide basic corporate information about the foreign investor, along with an outline of the proposed transaction. This shall be submitted to the French Treasury Department, who will review both the transaction and the foreign investor profile. The French Treasury Department must give a definitive response within two months. Failing this, the authorisation is deemed granted and the transaction may proceed.

[6-14] The French Treasury Department may give an authorisation contingent on specific undertakings, in view of ensuring the protection of French national interests, if they believe that the transaction may potentially cause a risk. Examples include undertakings to preserve the business operations of certain industries such as research and development, undertakings to preserve the safety of the supply chain, guarantees as to the performance by companies that have their registered office in France under procurement contracts, or contracts concerning public safety, national defense or research, or the production or trading of weapons, ammunitions or explosive powder or substances.

[6-15] The French Treasury Department must review whether or not the implementations of conditions such as those outlined above would be sufficient to ensure the protection of French national interests

2.3.2 Sanctions:

[6-16] The authorisation regime, being the only barrier to foreign investment in France, is highly regulated and heavily sanctioned. Therefore, failure to comply

with the regime leads to a wide range of sanctions. A distinction is made between civil and criminal sanctions, as outlined below.

(a) Civil: A foreign investment carried out in contravention of the prior authorisation regime may be sanctioned by a civil fine of up to twice the amount of the foreign investment itself. In addition, any agreements or contractual provisions which relate, either directly or indirectly, to the foreign investment that has not complied with the authorisation regime is deemed null and void and will therefore be unenforceable. This can be used by third parties also, who may invoke this nullity in order to annul the investment transaction.

(b) Criminal: criminal sanctions may be imposed on the foreign investor. These may include imprisonment for up to five years of the culpable parties involved in the transaction, seizure of the foreign investment and a fine of up to twice the amount of the foreign investment. This fine may be multiplied by five if legal entities are held liable for the offense.

2.4 EU Proposal

[6-17] The EU Commission has recently released a proposal pertaining to the possibility of an EU framework regarding foreign investment screening. This was prompted by a letter written by the economy ministers of France, Germany and Italy to the European Commission calling for tighter controls on foreign investment to protect against investments which do not comply with market rules or which cause market disturbance. They highlighted the frequent lack of reciprocity by non-EU countries and a possible sell-out of European expertise to non-European investors.

[6-18] In the State of Union 2017 Letter of Intent, President Juncker announced that the Commission intends to launch an EU-level framework for screening investments, whereby Member States may justify restrictions on capital movements under the ambit of 'security and public order reasons'. The proposed directive will allow for more transparency and greater equilibrium between Member States concerning foreign investments, insofar as they will be required to share information of this sort with one another and with the European Commission. The European Commission will have the power to conduct foreign investment vetting and deliver non-binding decisions. If this proposal comes to fruition, it is possible that investment into the EU by non-EU countries will become much more regulated.

3. Competition and Antitrust

[6-19] There have been major reforms in recent years within the area of competition and antitrust law which have extended the powers of France's Competition Authority (Autorité de la Concurrence, hereafter referred to as **FCA**). The FCA has the mission of ensuring competition in markets at French and international levels. It is responsible for the sanction of and the fight against anti-competitive practices. The

European Competition Network (**ECN**) is the European organisation in charge of coordinating the European competition policy. It creates a mechanism by which the National Competition Authorities of each EU Member State can cooperate with one another. The ECN provides the means to ensure the effectiveness of the National Competition Authorities' individual competition rules.

[6-20] Competition law applies equally to all companies in France, whether foreign or French, and is aimed at preventing anti-competitive agreements or unfair conduct by companies towards other companies or customers, particularly by companies holding a dominant market position. The FCA issues guidance on competition law compliance and examines the effect of mergers on competition. The Minister of the Economy retains the power to request a new investigation into the proceedings of a company or reverse a merger transaction. If Competition law is infringed upon, sanctions are enforced by the FCA and, in limited cases, by commercial courts.

[6-21] The Macron Law, which was adopted in August 2015, provides for many reforms in the area of Competition law. Amongst other reforms, it provides for a fine reduction for anti-competitive practices similar to that of the settlement procedure before the European Commission, whereby a company can be granted a fine reduction of up to 10% under EU Regulation 773/2004 of 7 April 2004 and Regulation 622/2008 of 30 June 2008. In order to avail itself of this reduction, the company must agree to refrain from challenging the formal statement of objections issued by the FCA after an infringement investigation. The maximum fine is 10% of the worldwide turnover of the relevant group under both French and EU law.

3.1 Merger control

[6-22] M&As which fall within the jurisdiction of the FCA must obtain clearance before their implementation, and this must be completed before the closing of any transaction. Those that meet the EU thresholds described below are required to notify the EU Commission only. If not, and the merger meets the conditions of French notification rules or the notification rules of any other Member State of the European Union, notification must be made to the relevant authority in that Member State as well.

[6-23] Transactions that must be reported to either the FCA or the Commission include the following:

(a) Considered to be a *concentration* within the meaning of EU and French law, ie a transaction which involves the changing of the nature of control of the target company. This includes not only ordinary mergers and joint ventures, but also acquisitions of direct or indirect control over a company; or

(b) Which meet the relevant turnover thresholds.

[6-24] France:

(a) The combined pre-tax turnover worldwide of all companies or groups of individuals or of legal persons who are parties to the concentration is more than €150 million;

(b) The total pre-tax turnover generated in France by at least two of the companies or groups of individuals or of legal persons who are parties to the concentration is more than €50 million; and
(c) No 'EU dimension'
  (i) Note: there are specific and lower thresholds for concentrations in the retail sector and French overseas.[2]

[6-25] EU (two alternative ways):

(a) The combined aggregate worldwide pre-tax turnover of all the parties to the concentration is more than €5 billion;
(b) The aggregate EU-wide turnover of each of at least two of the parties to the concentration is more than €250 million; and
(c) Each of the parties to the concentration does not achieve more than two-thirds of its aggregate pre-tax EU-wide turnover within one and the same EU Member State

OR

(a) The combined aggregate worldwide turnover of all the parties to the concentration is more than €2.5 billion;
(b) In each of at least three EU Member States, the combined aggregate pre-tax turnover of all the parties to the concentration is more than €100 million;
(c) In each of at least three EU Member States included for the purposes above, the aggregate pre-tax turnover of each of at least two of the parties to the concentration is more than €25 million; and
(d) The aggregate pre-tax EU-wide turnover of each of at least two of the parties to the concentration concerned is more than €100 million, unless each of the parties achieves more than two-thirds of its aggregate pre-tax EU-wide turnover within one and the same EU Member State.

[6-26] The sanctions for not notifying a reportable concentration can be serious and the fines can be set at up to 5% of the pre-tax turnover achieved in France and up to 10% of the aggregate pre-tax turnover worldwide at the EU level.

3.1.1 Procedure

[6-27] The FCA or the Commission must issue a decision within 25 days after the receipt of the notification, in the absence of an extension to negotiate commitments or 'stop the clock', either to:

(a) authorise the concentration; or
(b) open an in-depth investigation.

2 Source: The criteria for meeting the threshold is in Article R430-1 to R430-10 in the French Code of Commerce.
Note: By default the transaction will be first reviewed under EU law (Regulation 139/2004), and if it does not meet the criteria it will be examined under R430 of the French Code of Commerce.

[6-28] The purpose of the in-depth investigation is to determine whether the concentration may impede competition and, if it does, whether this can be offset by positive effects. If the FCA and the Commission decide that the concentration is anti-competitive and cannot be offset, it will be either prohibited or authorised subject to commitments to restore competition.

3.2 Antitrust law

[6-29] Both EU and French law prohibit cartels and other anti-competitive agreements, including abuse of a dominant position in the market. These are heavily sanctioned by both the FCA and the Commission, who may impose fines of up to 10% of the aggregate world pre-tax turnover.

[6-30] Where there has been conduct which is anti-competitive and qualifies as abuse of a dominant position, full or partial immunity may be obtained if the company applies for leniency by reporting the infringement to the FCA or the Commission. Often this is done at the time of the acquisition of a company, where abuse or anti-competitive practices may be uncovered whilst conducting due diligence. Leniency can be granted subject to the value of the information provided and the applicant's place in the list of companies applying for the same leniency. Full immunity from sanctions can only be obtained by the first company to apply.

[6-31] The French Law 2015-990 for economic growth and activity, known as the 'Macron Law', introduced specific measures in the retail sector also. The FCA must be provided with any agreement between independent companies active in the retail sector for consumer products or between central purchasing entities, where that agreement pertains to the joint negotiation of the purchase or the selection of products from suppliers. Such agreements must be submitted to the FCA at least two months prior to their implementation and the FCA may initiate proceedings if such an agreement raises competition concerns under Article L420-1 of the French Commercial Code, which provides for a general prohibition of anti-competitive agreements.

4. Capital Controls

[6-32] As a general rule, there are no capital control measures in France. However, disclosure to the French tax authorities is mandatory.

5. Security Controls

5.1 Pertaining to cash control

[6-33] Regulation 1889/2005 of the European Parliament and of the council of 26 October 2005 on control of cash entering or leaving the EU Community establishes an obligation to declare movements of €10,000 or more at border controls. This is in order to prevent money laundering and the financing of illegal activities.

2. Foreign Direct Investment and Ownership in Belgium

2.1 The Belgian corporate framework

[7-7] Belgium has a history of inviting and encouraging foreign investments. To this effect, there are no general prohibitions against foreign investment or ownership of business entities or real property. Furthermore, the government has created a favourable climate for private initiatives and has taken, and is taking, steps to further stimulate foreign investments in Belgium.

[7-8] Generally, foreign companies that want to operate in Belgium will incorporate a subsidiary in Belgium. As an alternative, they can set up a branch office.

[7-9] Belgian corporate law offers several forms of corporate entities, among which the most frequently used in practice - and the most commonly chosen by foreign investors - are either the limited liability company (*société anonyme/ naamloze vennootschap*) (**SA/NV**) or the private limited liability company (*société privée à responsabilité limitée/besluiten vennootschap met beperkte aansprakelijkheid*).

[7-10] We analyse below the main features of the Belgian corporate framework a foreign investor is likely to face and will have to address when investing in Belgium: (a) potential implications of securities law (see 2.2 below); (b) corporate governance rules (see 2.3 below); and (c) Ultimate Beneficial Owner (**UBO**) identification obligations on foreign investments (see 2.4 below).

[7-11] As the Belgian Government is working on further improving the attractiveness of Belgium for foreign investors by reforming the companies code as well as the corporate income tax code, this chapter also sets out briefly the main axis of these reforms (see 2.5 and 2.6 below).

[7-12] Finally, we will address the financing methods for M&A activities in Belgium (see 2.7 below).

2.2 Securities law implications

2.2.1 Introduction

[7-13] Belgian securities law can impact investments and ownership at several levels and, among others, the transferability of shares (see 2.2.2), transparency obligations for non-listed and listed companies (see 2.2.3 and (b)) and mandatory takeover bids (see 2.2.4).

[7-14] Applicable rules vary depending on the corporate structure at stake, the SA/NV is considered the most flexible vehicle in terms of transferability of securities.

2.2.2 Restriction on the transfer of securities

(a) SA/NV

[7-15] The transfer of securities, shares, subscription rights, convertible bonds, etc, issued by a SA/NV is, in principle, not restricted or limited.

[7-16] For registered securities, the sole formality to be carried out to ensure the enforceability of the transfer consists of a registration of the transfer in the securities register of the company. This recording is typically dated and signed by the transferor and the transferee or by their proxies.

[7-17] Even though the transfer of securities of a SA/NV is in principle free, any foreign investor should pay attention to possible contractual or statutory limitations to the transferability contained in the company's articles of association, authentic deeds of convertible bonds or subscription rights or any other agreements, such as shareholders agreements that can limit the shares' transferability *inter vivos*.

[7-18] In particular, inalienability clauses must be limited in time and be justified by the company's interests at all times.

(b) Private limited liability companies

[7-19] The acquisition or transfer of shares[2] in private limited liability companies is subject to the approval of at least half of the shareholders, owning three quarters of share the capital, after deduction of the shares proposed for sale, unless the company's articles of association contain more restrictive provisions.

[7-20] Such approval is not required for transfers between shareholders or to other persons specifically identified in the company's articles of association.

[7-21] The assignment or transfer of shares is only binding *vis-à-vis* the company and third parties as from the registration of the transfer in the shareholders register.

2.2.3 Transparency obligations

(a) Non-listed companies

[7-22] SA/NVs that have issued dematerialised shares, and unlisted shares, must be informed of any natural or legal person acquiring 25 percent or more of the voting rights in the company.

[7-23] The same declaration must be made when securities are transferred and the remaining voting rights fall below the aforementioned threshold of 25 percent.

2 The private limited company may not issue profit shares, convertible bonds or subscription rights.

(b) Listed companies[3]

[7-24] Any natural person or legal entity who acquires, directly or indirectly, the voting securities of a company listed on a regulated market and, in certain cases, on a Multilateral Trading Facility, must notify said company of the number and percentage of voting rights it holds as a result of this acquisition, when the voting rights attached to the securities, giving right to this voting right, reach 5 percent, and thereafter 10 percent, 15 percent, 20 percent and so on, of the existing voting rights of the concerned company.

[7-25] In practice, the articles of association of listed companies often provide for a 3 percent threshold, which triggers the notification obligation when crossed.

[7-26] The shareholders rights directive, Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, will decrease the transparency threshold to a 'maximum' lower threshold of 0.5 percent of the voting rights held by a shareholder. The directive must be implemented in the law of the Member States of the European Union by 10 June 2019.

[7-27] The same notification is mandatory in the event of the direct or indirect transfer of securities conferring the right to vote when, as a result of this transfer, the voting rights fall below one of the thresholds referred to above.

2.2.4 Mandatory takeover bids in listed companies[4]

[7-28] A person who, as a result of one or several acquisitions, holds more than 30 percent of the voting securities of a company with shares admitted to trading on a regulated market or a multilateral trading facility organised by Euronext Brussels will be compelled to launch a public takeover bid on all the potential voting securities it does not own in said company.

2.3 Governance structures of the SA/NV and the private liability company

2.3.1 SA/NVs

[7-29] SA/NVs are managed by a board of directors composed of at least two natural or legal persons, and a minimum three where the number of shareholders is higher than two. The directors are appointed by a general meeting of shareholders. They can be revoked at any time (*ad nutum*) and the term of their mandate may not exceed six years.[5] In exceptional cases duly justified by urgency and the social interest of the company, and if the company's articles of association authorises it, the decisions of the board of directors may be taken in writing by unanimous

3 Under Belgian law, as the private limited liabilities companies' securities may not be admitted to trading on a stock exchange, this section only concerns the SA/NV.

4 See note 3, above.

5 Stricter and more specific rules, which will not be examined here, are applicable to listed companies.

consent of the directors. This procedure may not be used for the approval of the annual accounts, the use of authorised capital or any other resolution that the company's articles of association would exclude.

2.3.2 Private limited liability companies

[7-30] Private limited liability companies are managed by one or more persons. The managers may be appointed for a limited or unlimited duration by the shareholders.

[7-31] Managers appointed in a company's articles of association are deemed to be appointed for the lifetime of the company. They may be revoked only for gross misconduct. Each manager may perform all acts necessary or useful for the accomplishment of the corporate purpose of the company, except those that the law reserves for the general meeting of the shareholders.

2.4 Identification of ultimate beneficial owners of Belgian companies

[7-32] The Belgian anti-money laundering (AML) legislation has been recently amended to implement Directive 2015/849 of the European Union.

[7-33] The main obligations in terms of AML for foreign investors who would acquire the control of a Belgian company can be summarised as follows.

[7-34] Appropriate and accurate information on the UBO, at least: name, birth date, nationality and permanent address, as well as detailed data on the economic interests held by the UBO of Belgian companies, non-profit organisations and foundations as well as some trusts must be collected and kept by and at the level of the Belgian company.

[7-35] The directors of the concerned legal entity will have to convey the relevant information to the UBO Register, as defined below, within one month of the date on which the abovementioned information is known or modified.

[7-36] The UBO is the person that controls the entity in law or in fact. Such control is deemed to exist when a person holds a participating interest of at least 25 percent of the shares or voting rights in the entity, therefore giving the person, in law or in fact, control over the administration of the company.

[7-37] Belgian law provides for the creation of a central register of beneficial owners of corporate and other legal entities incorporated in Belgium, the UBO Register. The UBO Register will be created within the General Administration of the Federal Public Finance's Treasury (the Belgian goverment has publicly announced the creation of the UBO Register for the third quarter 2018). As the modalities of functioning and organisation of the UBO Register, collecting of information, use of the information collected, etc, have not been put in place, the UBO Register is not operational yet.

[7-38] Although it remains unclear whether or not the UBO Register will be publicly accessible, it is certain that the reporting entities and tax authorities, for

the sole purpose of preventing money laundering and the financing of terrorism, will be given access.

2.5 Recent developments in Belgian corporate law

2.5.1 Context

[7-39] The Belgian Government is working on further improving the attractiveness and flexibility of the Belgian corporate law for both Belgian and foreign investors by reforming the corporate and association system.

[7-40] This reform of Belgian corporate law has not yet been passed (the Bill on the reform of the corporate and association system was introduced in the Belgian Parliament on 4 June 2018) but should imply the following consequences for private limited liability companies and SA/NVs.

2.5.2 Private limited liability company

[7-41] The current private limited liability company *will be drastically altered* with the aim of making this corporate form the 'natural' corporate form for any company, for both small and medium undertakings (**SMEs**) and large undertakings.

[7-42] The main characteristics of the 'new' private limited liability company would be:

(a) no minimum capital requirement;
(b) transfer of shares can be freely organised in the company's articles of association so that the private limited liability company can become a closed- or open-company following the intention of the parties;
(c) shares will be able to be admitted to trading onto the stock market; and
(d) possibility to issue *warrants,* subscription rights, and convertibles bonds.

2.5.3 SA/NV

[7-43] The SA/NV will become the preferred form for large undertakings and listed companies. The Code will increase their flexibility in the following ways:

(a) the option of having a unique founder/shareholder;
(b) the *ad nutum* revocability of the directors shall only by a default rule;
(c) governance will be executed through (i) a board of directors (one-tier structure) or (ii) a supervisory committee and an executive committee (two-tier structure) or (iii) through a unique director, only revocable for 'just cause';
(d) free transferability of shares, restrictions to this principle will be strictly regulated;

(e) the general meeting of a listed SA/NV will be initiated to grant a double voting right to registered shares under certain conditions (in particular, a two years uninterrupted holding period); and
(f) plural votes will be allowed in non-listed SA/NVs.

2.5.4 Nationality

[7-44] Under Belgian law, the nationality of a legal entity was previously determined by the location of its principal place of business. To cope with current economic and legal realities, the nationality of legal entities will now be determined according to the location of their registered office, regardless of their principal place of business.

2.6 Tax law

[7-45] The Belgian corporate tax landscape is expected to change as of 1 January 2018. In this respect, the major key achievements of this tax reform are:

(a) the decrease in corporate tax from a rate of 33.99 percent to 29 percent in 2018 and 25 percent as of 2020, and down to 20 percent for small and medium undertakings; and
(b) the introduction of a form of tax consolidation as of 2020. This new tax consolidation regime will allow Belgian companies of the same group to offset their tax losses against profits of another Belgian affiliated company. In other words, Belgian companies being part of a group will be allowed to make a deduction of one Belgian group entity's tax loss from another Belgian group entity's taxable profits in a given fiscal year. Nevertheless, in order to benefit from this tax consolidation regime, a 90 percent participation is expected to be required.

2.7 Financing of Mergers and Acquisitions

[7-46] Private equity-backed vehicles in the Belgian M&A sector usually obtain financing through a traditional secured term loan facility. Non-leveraged acquisitions by private equity investors remain rare. Equity investors are attracted to other alternatives such as mezzanine financing, subordinated convertible bond loans, preference shares, profit certificates and warrants, subscription rights.

[7-47] Although club financing and syndicated loans remain common practice, asset-backed lending has gained popularity over the past couple years.

[7-48] Financing continues to be readily available with reasonable conditions thanks to the historically low interest rates on bank financing in the first half of 2018. This can be explained by the fact that banks consider acquisition financing of smaller companies with a proven track record to be an additional source of income, inciting them to apply looser credit standards. It is noteworthy that in line with a more intensive use of bank financing in 2016, a decline in vendor loans and earn outs were noticed in 2017.

[7-49] The decline in vendor loans and earn outs is mainly due to a strong drop in the number of large deals. However, vendor loans are still used in almost half of the small deals.

[7-50] In these large acquisitions, on the other hand, high-yield bonds, which often come with a traditional secured term loan facility, are used more heavily. These are usually issued on larger markets and are rarely issued solely on the Belgian market.

[7-51] It is important to note that in Belgium, loans are syndicated either before or after the deal is completed, and that financial institutions request proper and solid securities for almost all transactions. In this regard, investors need to keep in mind that some restrictions are provided in the Belgium companies code in respect of financial assistance, i.e. cash advances, loans or securities granted by private limited liability companies and SA/NVs to third parties for the acquisition of the said SA/NV or SA/NV's shares by such third party. The approval of the general meeting by a two thirds majority is, among others, one of the requirements to be met by the company when granting such financial assistance to a third party.

[7-52] It is common practice in Belgium that multiple lenders benefit from a security through a parallel debt structure. This is because Belgian law does not recognise the common law concept of a 'security agent'. Therefore, securities can only be vested in favour of a creditor, and each original lender needs in principle to be a party to the security agreement.

[7-53] Industrial players are increasingly resolved to finance deals through their existing credit lines or sometimes even through their own funds.

[7-54] On the documentation front, the London Loan Market Association model remains the benchmark for drafting credit documentation and the refinancing of deals remains important in practice.

3. Competition Law - Need for Antitrust Pre-clearance Notification/Approval

3.1 Belgian and EU legislation

[7-55] The Belgian antitrust rules are contained in book IV of the Belgian Economic Code, specifically Articles IV.6-IV.11 and IV.58-IV.63. Antitrust rules at the level of the European Union are regulated by the Merger Regulation (EC) 139/2004.

3.2 Transactions that are subject to Belgian antitrust rules

[7-56] Belgian merger control rules are applicable to all transactions resulting in a durable change in control due to (a) the merger of at least two previously independent undertakings or parts of undertakings, (b) the acquisition of direct or indirect control of one or more undertakings, and (c) the creation of a full function joint venture, ie, a joint venture performing all the functions of an autonomous economic entity on a lasting basis.

3.3 Thresholds for notification

[7-57] Mergers or changes of control, as defined by Belgian antitrust law, must be reported to the Belgian Competition Authority if both of the following thresholds are met:

(a) the concerned undertakings have a total turnover of more than €100 million in Belgium; and
(b) at least two of the concerned undertakings each individually generate a turnover of at least €40 million in Belgium.

[7-58] The turnover is calculated on the basis of the financial figures of the preceding financial year at group level, ie all the undertakings both controlling and controlled by the parties concerned.

3.4 Filing obligation and procedures

[7-59] Notification of the concentration to the Belgian Competition Authority is mandatory when the thresholds referred to in section 3.3 are met. This notification sets off one of two possible merger review processes: the 'normal' procedure or the 'simplified' procedure.

3.4.1 The 'normal' procedure

[7-60] The 'normal' procedure can be comprised of two phases after notification. The Belgian Competition Authority can approve the concentration in a first phase that can take up to 40 working days after notification. The decision period can be extended to 55 working days to allow the notifying party to submit remedies if the concentration might significantly impede competition.

[7-61] If the concentration raises serious concerns as to its compatibility, a second phase ensues during which, after further investigation, a final decision must be made within 60 working days. The second phase will be extended to 80 working days if remedies are offered by the parties.

[7-62] If the Belgian Competition Authority does not make its decisions within the required timeframes, the concentrations are deemed to be approved.

3.4.2 The 'simplified' procedure

[7-63] In the simplified procedure, the Belgian Competition Authority will give its approval in a written decision to the notifying parties within 15 working days. The simplified procedure is applicable to concentrations that fulfil one of the conditions listed below.

(a) When two or more undertakings will acquire joint control over an undertaking that has, or will have, no or limited activities in Belgium, which is the case when:
  (i) the turnover of that undertaking and/or of its contributing activities is less than €40 million in Belgium; and
  (ii) the total value of that undertaking's assets is less than €40 million in Belgium;

(b) When none of the parties involved in the concentration performs activities in the same product and geographic market, or in a product market upstream or downstream from the product market in which another concerned party is active;

(c) When two or more undertakings merge, or gain sole or joint control over another undertaking:

(i) two or more of the concerned parties have activities in the same product and geographic market, but their combined market share is less than 25 percent; and

(ii) two or more of the parties concerned have activities in a product market upstream or downstream from the product market in which another party is active, but their separate or combined market share is less than 25 percent; and

(d) When a party acquires sole control over an undertaking over which it already has joint control.

3.5 Standstill obligation

[7-64] Belgian antitrust rules provide that a concentration may not be implemented as long as no decision has been taken clearing the concentration. The Belgian Competition Authority can, upon request of the parties concerned, provide an exemption to this standstill obligation.

4. Need for Prior Notification/ Approval for Foreign Investment in Belgium

[7-65] Without prejudice to what has been said above regarding the competition law, there are no regulations or restrictions applicable to foreign investments in Belgium across the board.

[7-66] Certain industries and sectors, e.g. banking and insurance, broadcasting, electronic communications, postal services, are specifically regulated. This specific regulation can contain a provision requiring notification to, or authorisation by, the competent regulator.

5. Foreign Exchange Controls

5.1 Business transactions with nationals, residents or non-residents

5.1.1 Introduction

[7-67] The existence of attractive tax regimes and investment incentives testify to the positive view the Belgian regional authorities have regarding foreign investments in Belgium.

[7-68] As a general rule, nationality is of little relevance when doing business in Belgium and no distinction is made between Belgian and non-Belgian companies. A natural person is considered a resident if her/his domicile, habitual residence or the seat of her/his wealth is in Belgium.

5.1.2 Requirements to set up a business in Belgium

[7-69] An investor that supplies goods or services, whether investing as a natural or legal person, is required to register for VAT purposes.

[7-70] Moreover, directors of 'large' companies, as defined under Belgian law, investing in Belgium are required to prepare full annual accounts whereas small companies can prepare simplified accounts which are much lighter in content. In addition, both 'large' and 'small' companies are required to prepare an annual report giving a true and fair view of the developments and results of the company.

[7-71] For most companies, the annual accounts and the annual report must be filed with the Belgian National Bank, although certain companies are exempt from this obligation. This is a recurring reporting obligation.

[7-72] Issuers of financial instruments listed on a regulated market must provide periodic and occasional information to the public. They must enable securities holders to exercise all the rights attached to the securities by providing them with all necessary information and facilities.

5.2 Investment controls

[7-73] Domestic and foreign companies are treated alike. This is also the case between branches and subsidiaries. Foreign entities therefore have the same legal obligations and rights as domestic entities. Both entities may sell or buy interests in and establish companies.

5.3 Money transfers

[7-74] Prior authorisation is not required for money transfers within Belgium or from foreign countries. Within the EU, the Payment Services Directive 2007/64 established a Single Euro Payments Area (**SEPA**) without restrictions on cross-border payments. However, limits on amounts can be applied by the payment service providers to money transfers between bank accounts in different countries.

[7-75] There are no foreign exchange restrictions on the transfer of capital or profits, nor are there foreign exchange controls on hard currencies.

prohibition does not prohibit the lending of money by a company in the ordinary course of business if the lending of money is part of the ordinary business of the company. However, these exceptions will not be available for a listed company unless it has assets that are not reduced by the giving of financial assistance or, to the extent that those assets are reduced, the assistance is provided by a payment out of distributable profits, per CO, s 282.

[20-4] In addition to the exceptions, CO, ss 283–285 set out the authorisation procedures for giving financial assistance, subject to the satisfaction of the solvency test under CO, Pt 5, Div 2.

[20-5] Financial assistance is authorised if it is:

(a) not exceeding 5% of shareholder funds as disclosed in the most recent audited financial statements of the company;
(b) approved by all shareholders by written resolution before the assistance is given; and
(c) approved by shareholders by ordinary resolution.

1.2 Consideration shares

[20-6] Consideration may be satisfied by issuance of shares and such shares are generally referred to as consideration shares. Consideration shares are attractive to the seller if such shares are tradable in a liquid and open market, or there is a high appreciation potential. It is a common form of consideration in a corporate restructuring by way of merger and acquisition of the group companies.

[20-7] Before shares are issued as consideration shares, the issuer must ensure that proper corporate authorisations and approvals have been obtained for the issuance and allotment. CO, s 140 provides that the directors of a company are not allowed to allot shares or grant rights to subscribe to, or to convert any security into, shares in the company, unless the company has given its approval in advance by resolution of the company pursuant to CO, s 141. However, the prohibition does not apply to allotment of shares to the founding members or allotment by pro-rata offers to existing shareholders.

[20-8] Pursuant to the Listing Rules of Hong Kong,[2] in order to avoid having to convene general shareholder meetings from time to time for approving the issuance of new shares, it is a general practice for the shareholders of listed companies to grant a general mandate to its board of directors at its annual general meetings to issue a certain amount of new shares. The maximum number of shares permitted to be issued under a general mandate cannot exceed 20% of a listed company's then existing issued share capital plus the number of securities repurchased by the listed company since the granting of the general mandate, but subject to a maximum of 10% of the listed company's then existing issued share capital. The general mandate will expire at the conclusion of the next annual general shareholder meeting, unless renewed at such a meeting, or earlier if revoked or varied by subsequent shareholders' resolutions. If the number of

2 See Chapter 24, Listed and Public Company Issues, for an overview of issues in relation to listed companies.

new shares contemplated to be issued exceeds the limit of the general mandate, the board of directors must obtain a special mandate from the shareholders at a general shareholder meeting for such issuance and allotment.

1.3 Debentures

[20-9] A buyer may consider satisfying the consideration by issuance of debentures such as notes and bonds in favour of the seller. Usually such debentures will be interest-bearing so as to provide interest income to the seller in addition to the purchase price. It is a desirable financing option to the buyer if the interest rate payable under the debentures is lower than the interest rate which financing banks normally charge. It is common for the debentures to contain provisions specifying what will constitute events of default; upon the occurrence of default, the buyer's repayment obligation shall be accelerated. Certain debentures may be structured as convertible securities pursuant to which the seller may convert all or part of the debt into shares of the debenture issuer.

2. Calculation and Adjustment of the Consideration

2.1 Basis of consideration

[20-10] The parties are free to determine the basis upon which the amount of consideration will be calculated. For a share acquisition transaction, it is common for the amount of consideration to be determined with reference to the net asset value of the company, ie the value by which the aggregate of assets exceeds the aggregate of liabilities, and any goodwill of the company which reflects the company's favorable business prospects. For a company with limited assets or if the net asset value does not accurately reflect the company's true value, the determination of consideration is usually based on other references such as the price-earnings ratio. Before executing the definitive transaction documents, the parties may agree, in the heads of terms, on the principles for calculating the consideration. For instance, they may make reference to and exclusion of certain specified items in the target company's financial statements in order to avoid miscommunication in the negotiation process. In any case, it is not common for sellers to sell their shares at a price lower than the company's net asset value given that it represents the base value of the company.

2.2 Purchase price subject to earn-out

[20-11] The parties may agree that part of the consideration will be satisfied by way of earn-out payments post-completion. The calculation of earn-out payments is usually linked to the target company's performance after completion. Thresholds can be set and formulae can be agreed for such calculation. Such thresholds and formulae are usually determined by the parties based on the expected level of the target company's future profits. An earn-out payment can be attractive to a seller if it remains involved in the business of the target company post-acquisition. From

the buyer's perspective an earn-out payment arrangement can lower its risk of making a bad investment as it will not be obliged to make any earn-out payments unless the target company meets designated profit thresholds. Thus, an earn-out payment confines the buyer's investment to the initial purchase price paid upon completion.

[20-12] No matter how the earn-out payments are calculated, the parties should ensure that clear provisions as to timing, formulae and thresholds are made in the sale and purchase agreement.

2.3 Adjustments based on completion accounts

[20-13] It is common to find adjustment of consideration provisions in share acquisition transactions especially when the exchange and completion of the sale and purchase agreement do not take place simultaneously. In such cases, the buyer will usually request the seller and the target company to agree in the sale and purchase agreement that a set of completion accounts be prepared and reviewed by the buyer upon completion, or shortly thereafter, to ascertain the fair value of the acquisition at completion and lower the purchase price if the completion accounts show reduced net assets. This can lower the risk of overpayment by the buyer when the target company is worth less than the agreed purchase price.

[20-14] The sale and purchase agreement should clearly specify the mechanisms on the preparation and agreement of the completion accounts between the parties. The buyer should request that such accounts be prepared based on generally accepted accounting principles and on a basis consistent with the target company's prior financial accounts.

[20-15] The parties should also consider and provide in the sale and purchase agreement mechanisms for resolving differences in respect of the draft completion accounts or any calculations which may arise therefrom, and consequently affecting the total purchase price. The general commercial practice is for the parties to jointly appoint a reputable accounting firm as the adjudicator of the differences; the accounting firm's views and calculations will usually be conclusive and binding on both parties.

2.4 Locked box mechanism

[20-16] Locked box mechanism is a seller friendly mechanism. Under this mechanism, the parties would calculate the amount of consideration based on the target company's latest available historic financial accounts (the locked box reference date) and as the price cannot be adjusted after signing, it means the box has to be locked and the purchase price fixed based on the latest available historic financial accounts, ie the latest audited financial accounts of the target company, or sometimes, the latest management accounts.

[20-17] As the buyer cannot adjust the purchase price after the locked box reference date referred to above, the buyer is at risk for the target company's performance from the locked box reference date to the closing of the transaction

as the target company is still managed and controlled by the seller. Any loss made by the target company after the locked box reference date has to be borne by the buyer. Therefore, it is important for the buyer to ensure that there is no leakage from the target company to the seller during that time.

[20-18] As there will be payment made during the ordinary course of the target company's business, it is important for the parties to stipulate the categories of leakages that are permitted for the proper and normal operation of the target company. The parties have to agree on permitted leakages. For non-permitted leakages, the buyer can ask for indemnity from the seller.

[20-19] At closing, the buyer will pay the purchase price to the seller. In addition, the buyer may also pay accrued interest from the locked box reference date to the closing of the transaction, as applicable, given that the purchase price has been determined based on the accounts of the locked box reference date but paid to the seller only after the closing.

[21-4] Naturally, the buyer wants to obtain the most extensive warranty coverage possible and elicit all relevant information through disclosure to provide post completion contractual protection. To achieve this, the seller's warranties should be tailored to the information available and address the key issues that have arisen during due diligence, which the buyer has taken into consideration in setting the purchase price, generally the more bespoke the warranties are, the more difficult it is for the seller to resist them. Warranty clauses and schedules will account for a significant part of a share purchase agreement and negotiation of the warranties can take up a considerable amount of negotiation time.

2. Key Issues Involved in Negotiating Warranties

2.1 Who is required to give warranties?

[21-5] Although the word 'seller' is used throughout this chapter, in practice there may be more than one seller and not all of them will give all the warranties.

[21-6] If there is more than one seller, the buyer and its solicitors should consider as early as possible whether all the sellers will give the same warranties. If not, they need to determine who the appropriate parties are to compensate the buyer if there is a breach of warranty.

[21-7] If all the sellers are closely involved in the management of the target company or business, the buyer will expect all of them to give warranties as they are all receiving consideration and are in a position of knowledge to give the warranties.

[21-8] However, if only some of the sellers are involved in the management, despite the fact that they are all receiving consideration, some of the sellers may have no or very limited knowledge of the target company or business and so may be unwilling to give full warranties.

[21-9] Some shareholders who hold a relatively small number of shares or are institutional shareholders may be unwilling to give warranties.

[21-10] The primary factor for a buyer in agreeing to the identity of the warrantors should be who is receiving consideration rather than who has actual knowledge of the target company or its business. The buyer should consider the proposed warrantors' financial ability to pay potential warranty claims. If the buyer has concerns about the warrantor's financial standing, it will consider other practical options to secure payment. For example, it may take security in the form of a bank guarantee, or the parent company/a related party guarantee, or part of the purchase money may be deposited into a retention fund to be released only upon the expiry of warranty limitation periods.

[21-11] If warranties are given by more than one seller, the buyer will need to consider whether the sellers accept liability jointly, severally, or jointly and severally as well as the sellers' proportionate caps on liability, if any. The buyer

usually prefers the sellers to give the warranties on a joint and several liability basis rather than on a several liability basis.

[21-12] There is no legal obligation on the seller to give any warranties nor are there any implied warranties in a transaction agreement, as the contract law principle of *caveat emptor* applies. The buyer has to request to add warranties regarding the target company.

2.2 When are warranties made?

[21-13] The warranties are typically made as of signing of a share purchase agreement.

[21-14] In a transaction where completion takes place at a future date after signing of the share purchase agreement, the issue then arises as to whether warranties given at signing should be repeated at, or even at all times up to and including, completion by reference to the circumstances then prevailing when they are repeated.

[21-15] Repeating the warranties at completion protects a buyer from intervening events and liabilities which can give rise to a breach of warranty and places the risk of such events and liabilities on the seller.

[21-16] The mechanism for ensuring that the warranties are true and correct as of completion is the inclusion of a closing condition that the warranties originally made at signing must be true and correct as of completion. A senior officer of the seller will be required to provide a closing certificate on the seller's behalf certifying that the warranties are true and correct as of completion.

[21-17] If warranties are repeated at completion, the seller should seek the right to update the disclosure letter or prepare a supplemental disclosure letter at completion.

2.3 Scope of warranties

[21-18] Although the warranties in a share purchase agreement will vary from one agreement to another, a buyer will request the following typical warranties from a seller:

(a) the seller's title to the sale shares and its ability and entitlement to transfer them free of any encumbrances or third-party interests to the buyer;
(b) the accuracy of the financial accounts prepared by the target company to verify that the proposed purchase price is based on reliable information;
(c) the target company has duly paid all taxes which it is accountable to pay to the relevant tax authority;
(d) a wide range of matters relating to the target company's business undertaking, for example, target company owning its assets, the assets being in good working order and appropriately insured, the

expectation loss. In a share acquisition, the amount of damages will be the difference between the market value of the shares at the time the warranties were given had all such warranties been true, and the market value of the shares at completion, taking into account the breached warranty. The amount of damages will depend on a number of factors such as the type of business acquired, which warranty has been breached and the basis under which the purchase price was calculated.

[21-33] There may be consequential losses, ie losses that are an inevitable consequence of the breach of a warranty even though not directly resulting from such breach, and it may be recoverable, subject to the rules on causation and remoteness, including whether such losses resulted from the breach and whether such consequences of the breach were within the contemplation of the parties at the time of contracting. These losses usually do not form part of the expectation loss.

4.2 Remoteness

[21-34] The loss which a buyer seeks to recover for breach of warranty must not be too remote, such that the loss has to be within the reasonable contemplation of the parties as at the time of execution of a share purchase agreement, taking into account any special circumstances known or communicated to both parties.[1] The test of remoteness is one of foreseeability.

[21-35] The rules on remoteness are applied by the courts when the parties have not specified, in a share purchase agreement, the consequences that flow from any breach. For example, the courts will not examine remoteness if a liquidated damages clause is agreed upon by the parties.

4.3 Duty to mitigate

[21-36] Damages for breach of warranty will be reduced to the extent that a buyer fails to mitigate its loss. It is common for a seller to supplement the common law duty to mitigate by expressly imposing, usually in the limitation of liability provisions in a share purchase agreement, obligations as to what action the buyer must defend/take against third parties and ensure that counterbalancing benefits, such as a reduction in tax, are taken into account in reducing damages.

4.4 Misrepresentation

[21-37] Under common law, regardless of whether a misrepresentation is innocent, negligent or fraudulent, the claimant will be entitled to rescission of the contract as a remedy. MO, s 2 provides that even if the misrepresentation has become a term of the contract which has been performed, the claimant would be entitled to rescind the contract. Therefore, rescission is available as a remedy to the buyer even if representations are made as warranties or if the sale and purchase has been completed. However, rescission may be barred if the buyer affirmed the sale and purchase agreement after becoming aware of the misrepresentation, by

1 See *Hadley v Baxendale* (1854) 156 ER 145.

the lapse of time, if the rights of a third party is prejudiced or if the parties cannot be restored to the pre-contractual position. Rescission is of limited value if the misrepresentation is only revealed after completion.

[21-38] The damages that can be awarded for a misrepresentation will depend on the type of misrepresentation involved. There are three types of misrepresentation – fraudulent, negligent or innocent.

[21-39] A fraudulent misrepresentation is where the seller made the representation knowing it to be untrue or without believing in its truth or is reckless as to its truthfulness,[2] and under common law the buyer would be entitled to claim damages for all losses which flow directly from the fraudulent misrepresentation.

[21-40] To claim damages for negligent misrepresentation under common law, it must be shown that there is a 'special relationship' between the parties so that the seller owes a duty of care towards the buyer, as the damages for negligent misrepresentation are based on a claim in tort for economic loss.[3] The damages for negligent misrepresentation would be based on reliance loss, as to put the buyer back into the position it would have been in if the misrepresentation had not been made, which would include the purchase price as well as other costs incurred in entering into the sale and purchase. However, MO, s 3(1), which applies to negligent misrepresentations, entitles the buyer to a measure of damages applicable to a fraudulent misrepresentation (which is much more extensive than that of negligent misrepresentation at common law). A buyer does not have to prove any 'special relationship' between it and the seller. Therefore, it is preferable to rely on MO, s 3(1) in case of a negligent misrepresentation.

[21-41] MO, s 3(1) expressly excludes innocent misrepresentation from its scope so that it will not apply to a situation where the seller making the representation had reasonable grounds to believe and did believe up to the time the contract was made that the facts represented were true. Therefore, no damages may be recoverable for an innocent misrepresentation under MO, s 3(1) or common law. However, under MO, s 3(2), a court may award damages in lieu of rescission if it is of the opinion that it would be equitable to do so, but still the buyer cannot claim purely for damages for an innocent misrepresentation.

5. Indemnity

[21-42] There is a fundamental difference between warranties and indemnities even though they are often considered together.

[21-43] An indemnity is a covenant by a seller to reimburse the buyer in respect of a particular type of liability should a specified event arise. It is a free-standing mechanism which establishes an automatic right to payment under given circumstances. Unless otherwise agreed upon, the buyer may enforce the indemnity as soon as liability to the third party arises, even before payment. The purpose of

2 It should be noted that one must specifically plead fraud in a claim, which is very difficult to prove.

3 See *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.

(a) **Substantial shareholders** means individuals and corporations who are interested in 5% or more of any class of voting shares in a Hong Kong listed company; they must disclose their interests and short positions in the voting shares of the listed company; and

(b) **Directors and chief executives of a listed company** must disclose their interests and short positions in any shares in a Hong Kong listed company, or any of its associated corporations, and their interests in any debentures of the listed company, or any of its associated corporations.

[24-5] In respect of substantial shareholders, there are various specified events which will give rise to an obligation of disclosure. To name a few in the context of a simple sale and purchase:

(a) when one first becomes interested in 5% or more of the shares of a Hong Kong listed company;[3]

(b) when one's interests drops below 5% of the shares of a Hong Kong listed company;[4] or

(c) when there is an increase or decrease in the percentage figure in one's holding that results in his/her/its interest crossing over a whole percentage number which is above 5%.[5]

[24-6] For directors or chief executives of a listed company in Hong Kong, the disclosure requirement is more vigorous and there is no minimum threshold for disclosure, so that the acquisition by such persons of any shares or any change in such persons' shareholding in the listed company or any of its associated corporations would trigger the disclosure requirement, regardless of the percentage.[6]

[24-7] If a selling shareholder holding 40% shares in a Hong Kong listed company enters into a sale and purchase agreement with a buyer who agrees to acquire all those shares and who, prior to the transaction, had no interest in shares in the listed company, both the seller and the buyer will have to make disclosures as to their disposal and acquisition of such shares pursuant to the requirements of SFO, Pt XV. The buyer's disclosure will be treated by SFO as having an interest in shares of a Hong Kong listed company even if its right is conditional. Therefore, the buyer's obligation to make disclosure arises once it has executed a sale and purchase agreement even if completion of the transaction will be subject to the fulfilment of certain precedent conditions.

[24-8] For most of the specified events, notification shall be made within three business days from the date when one knows of the relevant event. All notifications must be made under the forms specified by the Securities and Futures Commission (**SFC**) for such purpose. There is no territorial limit to the application of the disclosure requirement. Foreign residents or overseas incorporated companies are subject to the notification requirements. Notices not duly filed are a criminal offence.

3 SFO, s 313(1)(a).
4 SFO, s 313(1)(c).
5 *Ibid.*
6 SFO, s 341(1).

3. Listing Rules

3.1 Listed company

[24-9] A Hong Kong listed company has to be aware of its continuing obligations to make disclosure of any price sensitive information under the Listing Rules. If the sale and purchase of its shares between a selling shareholder and a buyer is price sensitive in nature in the opinion of the board of directors of the listed company, it must make an announcement and disclose the material information pertaining to the transaction according to the Listing Rules. Suspension of trading in its shares will be required pending announcement of such information. Such disclosure obligations have been codified under SFO since 1 January 2013. Non-compliance can result in civil and criminal liabilities.

3.2 Notifiable transactions

[24-10] If the seller and/or the buyer is a Hong Kong listed company, the sale and purchase may constitute a notifiable transaction under the Listing Rules which are subject to announcement, circular, reporting and shareholder approval requirements unless otherwise exempted.[7]

[24-11] Depending on the nature and size of the transaction, notifiable transactions are categorised in accordance with the applicable percentage ratios calculated under the five size tests.[8] The types of notifiable transaction are:

(a) share transaction – where all applicable percentage ratios are below 5%;

(b) discloseable transaction – where all applicable percentage ratios are 5% or more but less than 25%;

(c) major transaction (disposal) – where all applicable percentage ratios are 25% or more but less than 75%;

(d) major transaction (acquisition) – where all applicable percentage ratios are 25% or more but less than 100%;

(e) very substantial disposal – where all applicable percentage ratios are 75% or more; and

(f) very substantial acquisition – where all applicable percentage ratios are 100%.

[24-12] Further, if the transaction falls within the definition of connected transactions under the Listing Rules,[9] the transaction will be subject to announcement, reporting and independent shareholder approval requirements unless exempted.

[24-13] The parties should consult their legal advisers to ensure proper compliance with the Listing Rules.

7 MBLR 14.33.
8 MBLR 14.06 – 14.09.
9 MBLR 14A.23 – 14A.30.

had been an injection by the parent company into its foreign subsidiary for the purpose of enabling the financial assistance.

[25-4] In brief, the term financial assistance is defined under CO, s 274, to include assistance given by way of:

(a) a gift;
(b) a guarantee, security, indemnity, release or waiver;
(c) a loan, novation or assignment of a loan or any other similar agreements; or
(d) any other financial assistance given by a company if its net assets are thereby reduced to a material extent or if it has no assets.

[25-5] What constitutes financial assistance is not clearly defined, and one has to examine the commercial realities of the transaction and decide whether it can be described as the giving of financial assistance by the company, bearing in mind the section is a penal one and should not be strained to cover transactions which are not fairly within it.[2]

[25-6] If a company contravenes the general prohibition, the company and every responsible person of the company is liable to a fine of HK$150,000 and to imprisonment for 12 months.[3] Any director breaching the general prohibition may be found in breach of his or her duties to the company. However, CO, s 276, provides a saving provision for financial assistance given in contravention of the general prohibition so that the validity of the financial assistance and any contract or transaction connected with it will not be affected only because of the violation.

2. Transactions Not Prohibited by CO, s 275

[25-7] Under CO, s 278, a company is not prohibited from giving financial assistance for the purpose of an acquisition of its own shares or its holding company or for the purpose of reducing or discharging a liability incurred for such an acquisition if:

(a) the principal purpose of giving the financial assistance is not for the acquisition of the shares or for reducing or discharging a liability incurred for such an acquisition, or that such an acquisition is an incidental part of some larger purpose of the company; and
(b) the assistance is given in good faith in the interests of the company

[25-8] A distinction should be drawn between the purpose for which a company gives financial assistance and the reason or motive for doing so. In an English case, *Brady v Brady* [1989] AC 755 (HL), involving an equivalent statutory provision in the UK Companies Act 1985, the House of Lords held that larger is not the same as more important nor is reason the same as purpose. If the only purpose of the financial assistance is to enable the shares to be acquired, the financial

2 See *Charterhouse Investment Trust Limited v Tempest Diesels Ltd* [1986] BCLC 1.
3 CO, s 275(4).

and commercial advantages flowing from the acquisition that form the reason for forming the purpose of providing financial assistance are merely a by-product of the purpose rather than an independent purpose of which the financial assistance can be regarded as 'incidental'. In a Hong Kong Court of First Instance case, *Re Nu-West Natural Product Corp* [2010] 4 HKLRD 208, [2010] HKCU 1655, the court considered Former CO, s 47A,[4] and agreed with the House of Lords' opinion in *Brady*. In the Hong Kong case, the reason the company provided security, ie financial assistance, for the acquisition of its own shares was to settle disputes between two shareholders, but the purpose of such security was still to enable the company's shares to be acquired. Therefore, it was held that it did not fall within the transactions that are not prohibited by Former CO, s 47A and was hence unlawful.

[25-9] Other exceptions to the general prohibition under CO, ss 277, 279 and 280 include:

(a) the distribution of a company's assets by way of dividend lawfully made or in the course of winding up the company;
(b) the allotment of bonus shares;
(c) the reduction of a company's share capital in accordance with CO, Pt 5, Div 3;
(d) the redemption or buy-back of a company's own shares in accordance with CO, Pt 5, Div 4;
(e) anything done in accordance with a court order under CO, Pt 13, Div 2;
(f) anything done under an arrangement made under s 237 of C(WUMP)O;
(g) anything done under an arrangement made between a company and its creditors that is binding on the creditors under C(WUMP)O;
(h) the lending of money by a company in the ordinary course of business if the lending of money is part of the ordinary business of the company, subject to special restrictions for listed companies, see below;
(i) the financial assistance given in relation to employee share schemes, subject to special restrictions for listed companies, see below; and
(j) the provision of loans to its eligible employees for the purpose of enabling them to acquire beneficial ownership of fully paid shares in the company, subject to special restrictions for listed companies, see below.

[25-10] In respect of listed companies, exceptions (h), (i) and (j) above will not apply unless:

(a) the company has net assets that are not reduced by the giving of the financial assistance; or
(b) to the extent that those assets are reduced, the assistance is provided by a payment out of distributable profits.

4 Note 1, above.

3. Authorisation Procedures for Giving Financial Assistance

[25-11] Both private and public companies may provide financial assistance subject to the satisfaction of the solvency test under CO, Pt 5, Div 2, and following one of the three procedures below:

(a) *Procedure 1*: if the assistance, and all other financial assistance previously given and not repaid, is in aggregate less than 5% of the paid-up share capital and reserves of the company (CO, s 283);

(b) *Procedure 2*: if the assistance is approved by written resolution of all shareholders of the company (CO, s 284); and

(c) *Procedure 3*: if the assistance is approved by an ordinary resolution (CO, s 285).

[25-12] All three procedures mentioned above require a resolution of the board setting out in full grounds that the company should give the assistance, that the giving of assistance is in the best interests of the company, and that the terms and conditions under which the assistance is given are fair and reasonable to the company.[5] On the same day of the board passing the resolution, the directors who voted in favour of the resolution will have to make a solvency statement,[6] which states that each of the directors making it has formed the opinion that the company satisfies the solvency test,[7] stating the date on which it is made and the name of each director making it, signed by each director making it to support the giving of the financial assistance.[8] The assistance should be given not more than 12 months after the day on which the solvency statement is made.[9]

[25-13] For each of the procedures stated above in **[25-11]**, the respective steps set out below should be followed.

3.1 Procedure 1

[25-14] Within 15 days of giving the financial assistance, a copy of the solvency statement and a notice containing the following information should be sent to each shareholder: class and number of shares; consideration paid or payable; name of the person receiving the assistance and, if different, the name of the beneficial owner of those shares; and nature, terms and amount of the assistance (CO, s 283(4)). If the company contravenes this requirement to notify each shareholder, the company and every responsible person of the company commits an offence and each is liable to a fine of HK$10,000 and to a further fine of HK$300 for each day during which the offence continues.[10]

5 CO, ss 283-285.
6 *Ibid.*
7 See **[25-18]**, below.
8 CO, s 206.
9 Note 5, above.
10 CO, s 283.

3.2 Procedure 2

[25-15] Before the assistance is given, it must be approved by written resolution of all members of the company.[11]

3.3 For procedure 3

[25-16] At least 14 days before the day on which the resolution of the company is proposed, a copy of the solvency statement and a notice containing the following information should be sent to each shareholder: nature and terms of the assistance; name of the person to whom it will be given; if it will be given to a nominee for another person, the name of that other person; the text of the resolution of the directors; and any further information and explanation to enable the shareholders to understand the nature and implications of giving the assistance. The giving of assistance must then be approved by ordinary resolution of the company, and must not be given less than 28 days after the day on which such ordinary resolution of the company is passed.

[25-17] An application can be made to court by shareholders holding at least 5% voting rights or representing at least 5% of the shareholders to restrain the financial assistance under CO, s 286, on the grounds that: (a) the giving of the assistance is neither in the best interest of the company nor of benefit to the shareholders not receiving the assistance; or (b) the terms and conditions under which the assistance is given are not fair and reasonable to the company or to the shareholders not receiving the assistance. The applicant shall within 7 days after the application is served on the company give notice to the Registrar of Company for registration by a Form NSC9. In such cases, the financial assistance must not be given until the application is finally determined or otherwise as the court orders.[12]

4. Solvency Test

[25-18] Under CO, s 205 a company satisfies the solvency test if:

(a) immediately after the transaction, there will be no grounds on which the company could be found to be unable to pay its debts; and

(b) either:

(i) if it intends to commence winding up within 12 months, the company will be able to pay its debts in full within 12 months of the commencement of the winding up; or

(ii) in any other case, the company will be able to pay its debts as they become due during the 12 months immediately following the transaction.

[25-19] In ascertaining whether a company is able to pay its debts, the test will be a cash flow test and the question is whether the company's financial position is such that it can continue in business and still pay its way. Factors relevant to the determination of whether a company is able to pay its debts include:

11 CO, s 284.
12 CO, s 285.

the Anti-Monopoly Commission of the State Council, which generally provides advisory opinions to other AML enforcement agencies for competition policies; the Price Supervision and Anti-Monopoly Bureau of the National Development and Reform Commission, which has jurisdiction over infringements related to pricing; the Anti-Monopoly and Anti-Unfair competition Bureau of the State Administration for Industry and Commerce, which has jurisdiction over infringements related to non-pricing; and the Anti-Monopoly Bureau of the Chinese Ministry of Commerce (**MOFCOM**), which has the exclusive power to enforce AML's merger-related provisions.

[26-4] For the first six months in 2017, MOFCOM received 202 notifications, reviewed 172 cases and closed 156 cases and conditionally approved 1 case. M&A transactions in the manufacturing industry gained the top ranking, accounting for 53% of the total cases closed, and M&A transactions between offshore entities continued to be active and accounts for 43% of the total cases closed.[2]

2.2 Filing requirements

[26-5] If a Chinese or foreign company has huge turnover in China, many of its M&As or joint venture activities may trigger the merger filing thresholds in China and require a filing with MOFCOM, even if the activity itself has very little nexus with the Chinese market.

[26-6] Triggering events for the filing of a notification of concentration:

(a) There is an obligation to notify MOFCOM of a transaction when the activity or transaction is a Concentration as defined under the AML; and

(b) The parties to the activity or transaction cross the relevant turnover thresholds.

2.3 Initial consideration

2.3.1 Is the activity/transaction a 'Concentration'? Will there be a change in the 'control' of the company/business?

[26-7] Under the AML, Concentration refers to: (a) two or more companies or businesses merge; (b) a company acquires control over one or more companies or businesses by acquiring their equity interest or assets; or (c) a company acquires control or can exert decisive influence over one or more companies or businesses by agreement or other means. Based on MOFCOM's practice, a Concentration will occur whenever a company acquires a majority stake in another company.

[26-8] In June 2014, MOFCOM issued new guidance[3] which shed light on the definition of 'control'. The guidance provides that, in determining control, MOFCOM would examine the concentration agreements and the articles

2 Source: http://fldj.mofcom.gov.cn/article/xxfb/201707/20170702609486.shtml

3 *Guidance Opinions on the Notification of Concentration of Undertakings* issued and effective on June 6, 2014.

of association of the parties, and would consider other factors, such as the purpose of the transaction, shareholding structure, shareholders' and directors' voting arrangements, the power to appoint and dismiss senior management, the relationship between shareholders and directors, and other material commercial or co-operative agreements. However, how MOFCOM weighs and evaluates each factor may vary from one case to another. Seeking legal advice will help the parties to resolve some of these issues.

[26-9] A newly-incorporated joint venture will be considered as a Concentration under the AML if at least two undertakings jointly control such joint venture and may be subject to the filing requirements. The joint venture will not be regarded as a Concentration if only one undertaking controls the joint venture but other undertakings do not have any controlling rights over the joint venture.

[26-10] Acquisition of equity or assets is not the only way to establish control. MOFCOM may consider that one party has control over another party through other means, for example, contracts, management rights, or even intellectual property licensing.

[26-11] However, a corporate restructuring involving a change in the shareholding of a company between holding companies within the same group will not be considered a Concentration because it will not entail a change of ultimate control.

2.3.2 Do the parties involved in the transaction cross the turnover thresholds?

[26-12] A company needs to file a merger notification with MOFCOM if either of the following thresholds (**Thresholds**) is applicable:

(a) The total worldwide turnover in the previous accounting year of all parties to the transaction — in many cases, it will be just the acquiring company and the target company, or the parent companies of a new joint venture — exceeds RMB10 billion, approximately US$1.53 billion[4] or €1.39 billion[5] or £1.1billion,[6] and at least two parties has a turnover of more than RMB400 million each, approximately US$61.2 million[7] or €55.6 million[8] or £44 million,[9] within China in the previous accounting year; or

(b) The total turnover in China in the previous accounting year of all parties to the proposed transaction exceeds RMB2 billion,

4 Based on exchange rate provided by: http://www.xe.com/ on 25 February 2016.

5 *ibid.*

6 *ibid.*

7 *ibid.*

8 *ibid.*

9 *ibid.*

approximately US$306 million[10] or €278 million[11] or £220 million,[12] and at least two parties has a turnover of more than RMB400 million each, approximately US$61.2 million[13] or €55.6 million[14] or £44 million,[15] within China in the previous accounting year.

[26-13] However, MOFCOM retains the discretion to investigate a Concentration even though the above notification thresholds have not been met if facts and evidence collected show that such Concentration has or is likely to have an effect of eliminating or restricting competition.

[26-14] 'Turnover' will include all turnovers in the previous accounting year minus all taxes and related charges. The calculation of a company's turnover will include the aggregate turnover of companies in the same group, ie, controlled by the same person or parent company, excluding intra-group turnover, and sales between companies of the same group.

[26-15] Under MOFCOM's interpretation,[16] if only a part of a business group is acquired, only the turnover of that part will be included in the calculation of the turnover on the seller's side. If a joint venture is created by two groups, the total turnover of all the businesses of both groups will be included. Further, if the same undertakings have concluded various concentrations consecutively within two years either by themselves or through other undertakings in a relationship of control with such undertakings, each of which does not reach the notification thresholds, shall be deemed as a single Concentration. Such Concentration shall be deemed to take place at the time of the last transaction. The underlying turnover shall be the aggregate amount derived from the multiple transactions.

[26-16] With respect to geographic location, the current practice will allocate turnover to the place where the customer is located, eg, turnover from cross-border sales will be allocated to the country of final destination.

2.4 The notification process

2.4.1 Who has to file

[26-17] The party acquiring control in the proposed transaction is obligated to file. Although the target company is not obligated to file, participation and assistance by the target in the filing is helpful, because both the acquirer and the target will be involved in the notification process. If there is a 'full' merger between the buying and selling groups, or if there is a creation of joint ventures, all the parties to the transaction will make a joint filing.

10 *ibid.*
11 *ibid.*
12 *ibid.*
13 *ibid.*
14 *ibid.*
15 *ibid.*
16 See note 3, above.

2.4.2 When to file

[26-18] The filing has to be made before closing of the transaction because there should be no closing before MOFCOM issues its approval. Before the issuance of approval, all parties to the transaction must avoid taking actions to complete or close the transaction, such as transfer of assets or management. Such actions may be considered by MOFCOM as completing the concentration before clearance, or 'gun-jumping', which is a violation of the AML and MOFCOM can issue sanctions.

2.4.3 Gathering of information

[26-19] MOFCOM requires substantial information including:

(a) Information on the parties to the transaction, including affiliated business entities;
(b) Information on the proposed transaction;
(c) Relevant market(s) and the competition conditions in the relevant market;
(d) Study of market access, is there any factual and legal barrier or limitation; and
(e) Any efficiency resulting from the proposed transaction, etc.

[26-20] A submission will require gathering of detailed information, competition study and relevant documents even if the partners enjoy a relatively small market share. This process is time-consuming, especially for first timers.[17]

2.5 Timeline for MOFCOM notification process

[26-21] The maximum timeline allowed for an anti-monopoly review under the AML is 180 days which consists of the following timelines of an initial review and an in-depth review of the MOFCOM.

[26-22] Firstly, MOFCOM has 30 days to conduct an initial review, which commences only after MOFCOM is satisfied with all the documents submitted by the notifying party and formally accepts the submission. MOFCOM often makes additional requests for supporting documents and raises questions, and it usually takes around 3 months for the notifying parties to complete the submission of supporting documents requested by MOFCOM and respond to its questions before MOFCOM formally accepts the submission. For example, for Coca Cola's planned US$2.4 billion acquisition of China Huiyuan Juice Group Ltd, Coca Cola submitted application documents to MOFCOM on September 18, 2008, but MOFCOM only formally accepted the case on November 20, 2008 after four rounds of requests for additional supporting documents.

17 Pursuant to the circular on the establishment of a security review system for M&A of domestic enterprises by foreign investors ('Circular 6') issued by the State Council's general office on 3 February 2011 and its Implementing Regulations, some M&A transactions involving foreign investors are subject to a security review by a ministerial joint committee of MOFCOM and the National Development and Reform Commission.

[26-23] After the initial review, if in MOFCOM's view an in-depth review investigation is necessary, it has an additional 90 days to complete such in-depth review which can be further extended to another 60 days provided that: (a) undertakings agree to such extension; (b) documents and materials submitted by undertakings are not accurate and need to be further verified; and (c) material changes of certain circumstances have occurred after the notification of undertakings. During the aforesaid review process, the transaction has to be suspended pending clearance from MOFCOM. Good preparation of the filing documents and data can shorten the process. Legal counsel should be consulted at an early stage to gather and organise the necessary information for submission.

2.6 Simplified *merger* review process

[26-24] As deal certainty and time to close are crucial for transaction parties, the Chinese government introduced a simplified anti-monopoly review procedure in 2014,[18] and made a significant step to speed up its anti-monopoly clearance. Cases under the following circumstances would be considered as simplified cases:

(a) At the same relevant market, the collective market share of all undertakings in-volved in the Concentration is less than 15%;
(b) The collective upstream and downstream market share of all undertakings in-volved in the Concentration which have upstream and downstream relation-ships is less than 25%;
(c) For undertakings involved in the Concentration which are neither at the same relevant market nor have any upstream or downstream relationship, the share in each market relevant to the transaction is less than 25%;
(d) Offshore joint venture established by undertakings involved in the Concentra-tion will not engage in business activity in China;
(e) Undertakings involved in the Concentration acquires equity or asset of an off-shore entity which does not engage in business activity in China; and
(f) A joint venture jointly controlled by two or more undertakings is controlled by one or more undertakings through Concentration.

[26-25] The scope of documents to be submitted to MOFCOM was narrowed under the simplified procedure in a number of ways. For instance, the notifying party for a simplified case is exempt from submitting documents related to names and shareholding structures of the onshore and offshore affiliated companies of undertakings involved in the Concentration, the demand and supply structures of relevant market, market access, horizontal or vertical cooperative agreements, and efficiency gained from the Concentration. The above changes, particularly the exemption of disclosure of demand and supply structures, which contains sensitive information of key suppliers and customers of undertakings, are strongly welcomed by transaction parties and investors.

18 The *Interim Rules on Application Standards for Simplified Cases of Concentrations of Undertakings*, the 'Interim Rules', and *Guidance Opinions on Declaration of Simplified Cases of Concentrations of Undertakings (Tentative)*.

[26-26] Most of the simplified cases will be completed within 30 days. For example, the first simplified case involving Rolls-Royce Holding's acquisition of Daimler's 50% shareholding in the joint venture jointly owned by the two parties only took 19 days to clear.

[26-27] In the first six months in 2017, the number of cases closed through the simplified procedure is 113, accounting for 72% of the total closed cases.

2.7 MOFCOM's main assessment criteria

[26-28] According to the AML, if a proposed transaction 'has or may have the effect of eliminating or restricting competition', MOFCOM shall prohibit such transaction, unless: (a) the positive effects of the Concentration significantly outweigh the negative effects; or (b) the Concentration is in the public interest.

[26-29] In reviewing whether a transaction will affect competition, MOFCOM will consider the following factors:

(a) Market shares in the relevant market(s), plus ability to control the market(s);
(b) Degree of concentration in the relevant market(s);
(c) Effect on future market entry and technological progress;
(d) Effect on consumers, suppliers, distributors, customers, competitors, users, etc; and
(e) Effect on the development of the Chinese economy.

[26-30] In reviewing these factors, MOFCOM will use the information submitted by the filing parties and the information and comments provided by, or obtained from competitors, industry and trade associations, and other interested parties.

2.8 Approvals and penalties

2.8.1 Prohibition or clearance subject to conditions

[26-31] According to the AML, if a proposed transaction will have the effect of eliminating or restricting competition, MOFCOM may:

(a) Block such transaction; or
(b) Approve such transaction subject to restrictive conditions.

[26-32] The parties are not allowed to close a transaction if MOFCOM decides to block the deal. If MOFCOM has serious competition concerns over a transaction, the parties may propose remedies such as divestiture of certain assets or business or restriction of certain activities such as licensing key technologies or terminating exclusive agreements. MOFCOM is open and pragmatic in evaluating such proposals and has accepted behavioural as well as structural remedies.

(d) The Waste Disposal Ordinance (Cap 354) (**WDO**) provides for the control and regulation of the production, storage, collection and disposal of waste, including chemical waste, clinical waste and industrial waste. Generally, WDO prohibits dumping waste in public places on government land, and provides for a licensing regime for waste collection services and disposal facilities.

(e) The Environmental Impact Assessment Ordinance (Cap 499) (**EIAO**) is aimed at avoiding, minimising and controlling the adverse impact of designated projects, such as railways, ship repairing yards, industrial estates and outdoor golf courses, so that they must comply with the statutory environmental impact assessment process and that environmental permits are required for their construction and operation.

(f) The Hazardous Chemicals Control Ordinance (Cap 595) regulates the import, export, manufacture and use of chemicals that are not pesticides and have potentially harmful or adverse effects on human health or the environment through an activity-based permit system.

[27-3] The Environmental Protection Department (**EPD**) is the main authority responsible for monitoring and enforcing environmental laws. Non-compliance with environmental laws can result in criminal and/or civil liabilities. Certain environmental legislations extend the liabilities of the environmental offences committed by a body corporate to its management. For example, if it is proved that an environmental offence committed by a body corporate was committed with the consent or was attributable to any neglect or omission on the part of a director or manager of the body corporate, the director or manager personally also commits the offence.[1]

2. Due Diligence Relating to Environmental Issues

[27-4] Violation of environmental laws may jeopardise a company's economic interest and reputation. A buyer may have to bear losses and liabilities if the acquired company fails to comply with any applicable environmental laws. Qualified professionals should be engaged to conduct site inspection on the sites of the target company to which the environmental matters relate.

[27-5] Typical information which a buyer should request in its due diligence questionnaire includes:

(a) all permits, licences and approvals issued by the relevant authorities;

(b) all notices issued by the relevant authorities regarding any inspections or imposition of sanctions or other relevant information;

(c) all information about any past, threatened, pending, existing, unresolved and potential disputes and sanctions in relation to environmental matters;

1 For example, APCO, s 47A.

(d) details of monitoring, control and reporting system and procedures of the target company in relation to environmental matters; and

(e) details of any environmental policies implemented and maintained by the target company.

[27-6] Certain environmental legislations require the relevant authorities to maintain information available for public inspection. For example:

(a) APCO, s 39 requires the appointed public officer to keep a register open for public inspection containing details of applications for licences, particulars and information in notices given to the EPD on the existing use of premises, all exemptions granted from licensing requirements and all licences required to be recorded by APCO and its regulations.

(b) WPCO, s 42 requires the Director of Environmental Protection to maintain a register open for public inspection containing prescribed particulars of all discharges and deposits for which a licence is in force, applications for such licences, and other applications and notices in connection therewith as may be required to be recorded by WPCO and its regulations.

(c) EIAO, s 15 requires the Director of Environmental Protection to keep a register open for public inspection containing information such as project profiles received, environmental impact assessment study briefs issued, and the grant of environmental permits as may be required by the relevant regulations.

3. Environmental Warranties and Representations

[27-7] If environmental matters are relevant to a sale transaction, the buyer should require the seller to give warranties and representations regarding environmental issues and compliance. Typical warranties and representations include:

(a) the validity of environmental licences and permits;

(b) due compliance with environmental laws, regulations and directions of the relevant authorities and the absence of risk of non-compliance thereto; and

(c) absence of existing or potential claims or disputes in relation to environmental matters.

[27-8] The seller should make sufficient disclosures to qualify its liabilities under the warranties and representations.

[27-9] If certain environmental issues are revealed through due diligence or disclosure by the seller, the buyer may require the seller to provide indemnities to cover any potential loss that may be incurred.

[28-5] Several exemptions and reliefs from stamp duty are available. The exemption from stamp duty in relation to transfer within a corporate group is most commonly used in corporate reorganisation. To qualify for this exemption, among other conditions to be fulfilled, the transferor and the transferee must be associated; in other words, they must have common ownership of not less than 90% of their issued share capital. The exemption is obtained by application.

1. Contract Note

[28-6] Although there is no statutory format for contract notes, SDO, s19(2), requires that a contract note contain the following particulars:

(a) whether the person effecting the sale or purchase of the Hong Kong shares is acting as principal or agent, and, if acting as agent, then the name of the principal;
(b) the date of the transaction and of the making of the contract note;
(c) the quantity and description of such Hong Kong shares;
(d) the price per unit of such Hong Kong shares and the amount of the consideration or, in the case of an exchange, particulars of the property for which such Hong Kong shares is exchanged; and
(e) the date of settlement.

2. Stamp Duty Payable

[28-7] Stamp duty for contract note is charged under head 2(1) of SDO, Sch 1. The current stamp duty for every sold note and every bought note is 0.1% respectively of the amount of the consideration or of the value of the shares. Therefore, the total rate of stamp duty on a transfer of shares of a Hong Kong company is effectively 0.2%.

[28-8] For stamp duty purposes, if the consideration is in a currency other than Hong Kong dollars, it will be converted into Hong Kong dollars by using the buying rate for the currency in question. This rate is determined by the Hong Kong Monetary Authority for telegraphic transfers at the commencement of business on the date of transfer or on the business day immediately preceding that date if that date is a Sunday or a general holiday.

[28-9] The value upon which the Hong Kong stamp duty is calculated is the higher of the consideration stated in the contract notes or the market value of the shares which is the subject of the contract notes. As a matter of practice, the Collector of Stamp Revenue (**Collector**) initially charges the stamp duty based on the consideration stated by the parties in the contract notes. However, under SDO, s 27(4), if the transfer of shares is not for valuable consideration and the Collector is of the opinion that a substantial benefit is conferred on the buyer of the shares by reason of inadequacy of consideration, then the transfer of shares will be deemed to be a voluntary disposition *inter vivos* under SDO, s 27(1), and the applicable charging head will be head 2(3) so that the stamp duty is calculated with reference to the market value of the shares. Therefore, if the stated consideration is substantially lower than the market value of the shares, the stamp duty will be assessed based on the market value of the shares as of the date of transfer. Given that there is no market

mechanism to value the shares of Hong Kong private companies, their value will be ascertained from the latest management accounts of the company as the audited accounts may not be up to date.

2.1 Deemed Consideration

[28-10] SDO, s 24, deems certain debts discharged, payments of money, transfer of stock and indebtedness incurred to be whole or part of the consideration for the sale of beneficial interest in Hong Kong shares, unless it can be shown that such amounts are independent from and not connected to the share transfer. This section is an anti-avoidance provision designed to tackle transactions involving 'disguised consideration' and 'disguised equity'.[2] 'Disguised consideration' refers to cases where part or all of the consideration paid by the buyer is not in the usual form of consideration, and such examples include the discharge of a debt due to the buyer by the seller, the discharge of the seller's debt to a third party, and if the buyer makes a payment to a third party specified by the seller.[3] 'Disguised equity' involves cases where a loan (usually a shareholder's loan) is used to finance the business of the target company, for example if the shareholder's loan owing from the target company to the seller is assigned together with share transfer to the buyer,[4] and if the buyer incurs liability for the shareholder's loan such as undertaking or guaranteeing its repayment.[5]

[28-11] SDO, s 24(2) provides relief for transactions caught by SDO, s 24(1), so that the total consideration subject to stamp duty will be reduced to the value of the beneficial interest in the shares transferred, so that where the debt agreed to be discharged is of a higher value than the shares transferred, the stamp duty is only payable on the value of the shares transferred.

2.2 Intra-group Relief

[28-12] Under SDO, s 45, if the transfer of beneficial interest in Hong Kong shares is from one associated body corporate to another, stamp duty will not be chargeable in respect of such transaction. The buyer and seller are 'associated body corporates' if one is the beneficial owner of not less than 90% of the issued share capital of the other, or if another body corporate is the beneficial owner of not less than 90% of the issued share capital of both the buyer and seller.[6]

[28-13] The relief under SDO, s 45, will not be available unless the Collector is satisfied that the share transfer was not made in pursuance of an arrangement in which: (a) all or any part of the consideration for the transfer of shares was provided or received, directly or indirectly, by a person other than an 'associated body corporate'; (b) the shares were previously transferred, directly or indirectly,

2 See Stamp Office Interpretation & Practice Notes No 3 by the Inland Revenue Department.
3 Caught by SDO, s 24(1).
4 *Ibid.*
5 Caught by SDO, s 24(3).
6 SDO, s 45(2).

by such person; or (c) the buyer and seller will cease to be 'associated body corporates' due to the buyer leaving the group.[7] Further, if the buyer and seller cease to be 'associated body corporates' as described in (c) above within two years of the date of transfer being stampable, and relief has been granted under SDO, s 45, the buyer and seller have to notify the Collector within 30 days of their cessation of being 'associated body corporates' and will be jointly and severally liable to pay the stamp duty which would have been payable had the relief not been granted.[8]

3. Procedures of Stamping

[28-14] The IRD explained in its official stamping procedures and explanatory notes that to enable the Stamp Office to assess the proper amount of stamp duty payable, the following documents and information must be presented together with the duly executed contract notes and instruments of transfer to the Stamp Office for stamping:

(a) the memorandum and articles of association of the Hong Kong company whose shares are being transferred;
(b) a certified true copy of the share sale and purchase agreement, if any, or a confirmation by letter signed by either the seller or the buyer that no such agreement exists;
(c) a statement on whether the company has acquired any landed property, rights to acquire landed property or investments and, if so, a completed schedule of property in the *pro forma* as required by the IRD, ie IRSD Form 102 Schedule of Landed Properties; and
(d) a set of documents depending on whether the company has commenced business or is just recently incorporated and hence no audited accounts have been prepared:
    (i) if the company has commenced business, then the following documents must be presented to the Stamp Office:
        - the company's latest audited accounts;
        - certified management accounts of the company made up to a date close to the date of transfer and, if not, then within 6 months prior to the date of the transaction;
        - a certified copy of the Return of Allotments for increase of share capital, if relevant; and
        - a certified copy of the resolution of meetings of directors for dividends paid or payable, if relevant.
    (ii) If the company is a recently incorporated company which has yet to commence business and hence no audited accounts have been prepared, then a written confirmation of such is required.

[28-15] The Stamp Office has the discretion to ask for additional documents when assessing the stamp duty payable.

7 SDO, s 45(4).
8 SDO, s 45(5A).

4. Time for Stamping

[28-16] Contract notes are required to be stamped within the following specified time periods after any sale or purchase of Hong Kong shares is effected:

(a) within two days after the sale or purchase if the contract notes are executed in Hong Kong; or
(b) within 30 days after the sale or purchase if the contract notes are executed outside Hong Kong, as a matter of practice in order to qualify for the 30 day-time limit, the location of execution should be stated on the contract notes.

5. Penalty for Late Stamping

[28-17] If the contract notes are not properly stamped within the specified timeframe, they can thereafter be stamped only upon payment of the stamp duty owing and a penalty. The penalty imposed will depend on the length of delay[9]:

(a) if the delay is no more than one month, the penalty shall be double the amount of the stamp duty payable;
(b) if the delay is more than one month but no more than two months, the penalty shall be four times the amount of the stamp duty payable; or
(c) in any other cases, the penalty shall be ten times the amount of the stamp duty payable.

[28-18] SDO grants the Collector discretion to remit the whole or any part of the penalty depending on individual circumstances.[10] Any request for remission of late penalty should be made in writing with full explanation of the delay and supporting evidence.

6. Legal Consequences of Failure to Stamp

[28-19] In general, an instrument effecting a transfer of Hong Kong shares is duly stamped only if it bears an endorsement by the Collector to the effect that the duty has been paid or that the instrument is not chargeable with stamp duty.

[28-20] Aside from a few exceptions, SDO provides that unless an instrument is duly stamped, it will be inadmissible in evidence and will not be 'available for any other purpose whatsoever'. A further consequence of failure to stamp an instrument properly is that the instrument may not be 'acted upon, filed or registered by any public officer or body corporate'.[11]

[28-21] Therefore, even if the share acquisition has been completed, the company's board of directors will refuse to register the sale shares in the name

9 SDO, s 9.
10 *Ibid.*
11 SDO, s 15.