

HONG KONG COMMERCIAL LAW

**Current Issues and
Developments**

Edited by Charles D. Booth



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Contents

Foreword		vii
Preface		ix
Contributors		xi
Table of Cases		xv
Table of Legislation		xxiii
Introduction	<i>Charles D. Booth</i>	1
CHAPTER ONE	A Patent System for Hong Kong <i>Henry J.H. Wheare</i>	5
CHAPTER TWO	Credit Card Fraud <i>Clive Grossman QC</i>	31
CHAPTER THREE	Transnational Insolvency Law <i>Charles D. Booth</i>	55

CHAPTER FOUR	Oversubscription of Initial Public Offerings: Success or Failure? An Analysis of Directors' Duties When Issuing Shares <i>I.A. Tokley</i>	103
CHAPTER FIVE	Disqualification of Company Directors <i>Caroline Hague</i>	125
CHAPTER SIX	Legal Dysfunctionalism: Hong Kong Company Law in the 1990s <i>Anne Carver</i>	155
CHAPTER SEVEN	Tax Aspects of Cross-Border Trade and Investment <i>Jefferson P. VanderWolk</i>	181
CHAPTER EIGHT	Asset Protection? Estate Planning? (Unit) Trust Me <i>Andrew J. Halkyard</i>	203
Index		223

Contributors

Charles D. Booth is a Lecturer in the Department of Professional Legal Education and an Associate Dean of the Faculty of Law at the University of Hong Kong, where he teaches Comparative and Transnational Insolvency Law in the LLM programme and lectures in Commercial Law and Practice in the PCLL. He received his BA in history from Yale University and his JD from Harvard Law School and is a member of the New York and New Jersey Bars. Prior to joining the University of Hong Kong, he practised law in New York City and taught at the William S. Richardson School of Law at the University of Hawaii. He has published many articles on a variety of insolvency topics, including comparative and transnational insolvency law and Hong Kong bankruptcy law reform.

Anne Carver is a Senior Lecturer in the Department of Professional Legal Education at the University of Hong Kong, where she lectures in Business Law to BBA and MBA students in the School of Business. She received her BA and MA at Cambridge and is admitted as a solicitor in Hong Kong and in England and Wales. She is the author of *Hong Kong Business Law* and also writes in the areas of trade union and employment law.

Clive Grossman QC is a barrister in Hong Kong and took silk in 1993. He received his BA and LLB from the University of Cape Town. Before coming to Hong Kong, he practised at the Bar in Rhodesia (later Zimbabwe), where he also served as Chairman of the Bar Council and acted as a

Deputy High Court Judge. He was a member of the Legal Department in Hong Kong from 1983–94. When he left government, he was Deputy Director of Public Prosecutions and head of the Commercial Crime Unit. His main areas of practice are criminal law, commercial law, and arbitration.

Caroline Hague is a Lecturer in the Department of Professional Legal Education at the University of Hong Kong, where she lectures in Commercial Law and Practice in the PCLL. She received her BA Honours Degree from Manchester University and is admitted as a solicitor in Hong Kong and in England and Wales. Prior to joining the University of Hong Kong, she practised law in Hong Kong with Johnson Stokes & Master. Her main areas of research are company and commercial law, in particular the role of company directors.

Andrew J. Halkyard is a Senior Lecturer in the Department of Professional Legal Education at the University of Hong Kong, where he teaches Taxation and Tax Planning in the LLM programme and lectures in Revenue Law in the PCLL. He is also a consultant to Baker & McKenzie. He obtained an LLB from the Australian National University and an LLM from the University of Virginia. He has published extensively on a variety of tax issues and is the co-author (with Peter Willoughby) of the *Encyclopaedia of Hong Kong Taxation* and the co-author (with Jefferson P. VanderWolk) of *Hong Kong Tax Law: Cases and Materials*.

I.A. Tokley is a consultant to an international firm of solicitors based in Hong Kong. He formerly was a Lecturer in the Department of Professional Legal Education at the University of Hong Kong, where he taught Securities Regulation to LLM students and Banking Law to LLB students. He received his LLB and LLM from the University of Adelaide and is admitted as a solicitor in Hong Kong, England and Wales, New South Wales, and South Australia. He is currently a Visiting Professor in Corporate and Securities Law at Tsinghua University in Beijing and has written several books, including *Company Securities: Disclosure of Interests and Law of Finance*.

Jefferson P. VanderWolk is a tax principal at Deloitte Touche Tohmatsu in Hong Kong. He formerly was a Lecturer in the Department of Professional Legal Education at the University of Hong Kong, where he co-taught Taxation and Tax Planning in the LLM programme and lectured in Revenue Law in the PCLL. He obtained his BA from Boston University, his MA from the American University in Cairo, and his JD from Columbia

Law School. He is a member of the New York and New Hampshire Bars and has practised law in New York and with Baker & McKenzie in Hong Kong. He has written widely on a variety of tax issues and is the author of *The Source of Income: Tax Law and Practice in Hong Kong* and *Practical China Tax Planning*.

Henry J.H. Wheare is the partner in charge of the intellectual property department at Lovell White Durrant. He received his BA and MA at Cambridge and is admitted as a solicitor in Hong Kong and in England and Wales. His practice covers all areas of intellectual property, with particular emphasis on patent law. He taught an LLM course on intellectual property at the University of Hong Kong in 1993–94. He is currently President of the Asian Patent Attorneys Association in Hong Kong and is general editor of *IP ASIA*.

Table of Cases

	<i>Page</i>
Allobrogia Steamship Corp, Re (1978)	80
Altim Pty Ltd, Re (1968)	129
American Express International Banking Corp v Johnson (1984)	72, 96–98
Anderson, Re (1911)	60, 62
Andrew, Re (1937)	72
Ansett v Butler Air Transport Ltd (No 1) (1958)	112
Ashbury Railway Carriage and Iron Co Ltd v Riche (1875)	168
Attorney General v Bouwens (1838)	210
Attorney General v Yeung Shun-shum (1987)	46
Austinsuite Furniture Ltd, Re (1992)	142
Australia-wide Management Ltd v CSD (NSW) (1992)	210, 212, 213
Axona International Credit and Commerce Ltd, In re (1988)	98, 99
Axona International Credit and Commerce Ltd, In re (1990)	98
Axona International Credit and Commerce Ltd, In re (1991)	98
Baker v Archer-Shee (1927)	209, 212, 213
Banque des Marchands de Moscou v Kindersley (1951)	79
Barnado's Homes v Special Commissioners of Income Tax (1921)	213
Bath Glass Ltd, Re (1988)	141, 142, 143–144, 149
Benson v Heathorn (1842)	118
Bicoastal Corp v Shinwa Co Ltd (1994)	74

	<i>Page</i>
Blithman, Re (1866)	60, 62
Board of Trade v Owen (1957)	44
Briess v Woolley (1954)	107
British Leyland Motor Corp v Armstrong Patents Co Ltd (1984)	13
British Leyland Motor Corp v Armstrong Patents Co Ltd (1986)	13
Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd (1974)	211
Canon Kabushiki Kaisha v Green Cartridge Co (Hong Kong) Ltd (1995)	5, 13
Catnic Components Ltd v Hill & Smith Ltd (1982)	18
Chan, In re (1993)	99
Chan Yee Nam, Re (1918)	91
Chan Yue Shan, Re (1908)	89, 91, 92, 95
Charles v FCT (1954)	209, 210, 213
Charterbridge Corp Ltd v Lloyds Bank Ltd (1970)	109
Chartmore Ltd, Re (1990)	148
China Tianjin International Economic and Technical Co-operative Corp, Re (1994)	77, 82
City Equitable Fire Insurance Co, Re (1925)	108, 110, 111, 126–127
City Investment Centres Ltd, Re (1992)	137–138, 149
Commissioner of Estate Duty v Ramchandani (1982)	218
Commissioner of Inland Revenue v Euro Tech (Far East) Ltd (1995)	189
Commissioner of Inland Revenue v Far East Exchange Ltd (1979)	182
Commissioner of Inland Revenue v Hang Seng Bank Ltd (1990)	185, 189
Commissioner of Inland Revenue v Wardley Investment Services (Hong Kong) Ltd (1992)	189
Compania Merabello San Nicholas SA, Re (1973)	79–80
Company (No 00359 of 1987), Re A (1988)	81, 82
Company (No 003102 of 1991), ex parte Nyckeln Finance Co, Re A (1991)	81
Copecrest Ltd, Re (1993)	150
Costa & Duppe Properties Pty Ltd v Duppe (1986)	210
Cotman v Brougham (1918)	169
Countess Fitzwilliam v IRC (1993)	216–217
Crestjoy Products Ltd, Re (1990)	151
Crumpton v Morrione Hall Pty Ltd (1965)	110–111

	<i>Page</i>
CS (Vic) v Yellowco Five Pty Ltd (1993)	219
CSD (Qld) v Livingston (1965)	210
Cuff Knox (1961)	212, 213
Dairen Kisen Kabushiki Kaisha v Shiang Kee (1941)	77
Dallhold Estates (UK) Pty Ltd, Re (1992)	92
Deak, R. Leslie v Deak Perera Far East Ltd (in liq) (1991)	85
Deak Perera (Far East) Ltd (in liq) v R. Leslie Deak (1995)	85–86
Denham & Co, Re (1883)	107
D'Jan of London Ltd, Re (1994)	127
Dovey v Cory (1901)	107
DPP v Stonehouse (1977)	45
Eades Estate, Re (1917)	91
Eloc Electro-Optieck & Communicatie BV, Re (1982)	80
Elscent (Asia-Pacific) Ltd v The Commercial Bank of Korea Ltd (1994)	186
Espin v Pemberton (1859)	162
Estate of Aw Hoe, Re (1957)	59–60, 66
European Asian Bank v Reicar Investments Ltd (1988)	169–170
Federal Commissioner of Taxation v Everett (1980)	211
Federal Commissioner of Taxation v St Helens Farm (ACT) Pty Ltd (1981)	119, 120
Felixstowe Dock and Railway Co v United States Lines Inc (1989)	63, 71
Firedart Ltd, Re (1994)	146
Foss v Harbottle (1843)	122, 173
Fraser v Whalley (1903)	112
Furniss v Dawson (1984)	198, 216
Galbraith v Grimshaw (1910)	65–66, 70
Gartside v IRC (1968)	210, 213–214
Godwin Warren Control Systems plc, Re (1993)	148
Guinness v Saunders (1990)	118
Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co (1968)	112, 113
Hely-Hutchison v Brayhead (1968)	118
Herbert, Elizabeth v Commissioner (1958)	195

	<i>Page</i>
Hirsche v Simms (1894)	110
Hogg v Cramphorn Ltd (1967)	111, 112, 113–114
Howard Smith Ltd v Ampol Petroleum Ltd (1974)	109, 111, 112, 114, 115
Hutcheson v Taylor (1931)	91
Hutton v West Cork Rlwy Co (1883)	110
Improver Corp v Raymond Industrial Ltd (1989)	11–12
Improver Corp v Raymond Industrial Ltd (1991)	12, 18
Improver Corp v Remington Consumer Products Ltd (1990)	18
Insurance Co of Pa v Grand Union Insurance Co (1988)	72
Introductions Ltd v National Provincial Bank Ltd (1970)	169
IRC v McGuckian (1994)	216
IRC v Reid's Trustees (1949)	209
Irish Shipping Ltd, Re (1985)	61, 76, 80–81 82–83, 86
Irish Shipping Ltd, Order, Re (1985)	75, 83
Irvine v Union Bank of Australia (1877)	164
Jon Beauforte (London) Ltd, Re (1953)	164, 167
Kan King Investment Ltd (in liq), Re (1995)	153
Keypak Homecare Ltd, Re (1990)	142, 146
Kleinwort Benson (Hong Kong) Trustees Ltd v Wong Foon Hang (1993)	210
Kooperman, Re (1928)	65, 87
Kowloon Container Warehouse Co Ltd, Re (1981)	68
Kwok Chi Leung, Karl v Commissioner of Estate Duty (1988)	216, 218
Law Ip Po, Re (1994)	210
Lee Behrens & Co Ltd, Re (1932)	113
Levasseur v Mason & Barry Ltd (1891)	67
Liangsiriprasert v Government of United States of America (1991)	46
Linvale Ltd, Re (1993)	154
Liwan District Construction Co v Euro-America China Property Ltd (1990)	99–100
Lo-Line Electric Motors Ltd, Re (1988)	142, 145, 149–150
Looe Fish Ltd, Re (1993)	147
Lyall v Jardine, Matheson, & Co (1870)	94
Macau-Mokes Group Ltd, Re (1994)	77

	<i>Page</i>
Manlon Trading Ltd, Re (1995)	151–152
Marshall, Re (1914)	212, 213
Marshall's Valve Gear Co Ltd v Manning Wardle & Co (1909)	107
Mattel Inc v Tonka Corp (1992)	24
Metropolitan Police Commissioner v Charles (1976)	47–48
Mobil Sales and Supply Corp v Owners of 'Pacific Bear' (1979)	63, 68–69, 70, 71
Modern Terminals (Berth 5) Ltd v States SS Co (1979)	60, 62–63, 66, 68, 69–71
Mosely v Koffeefontein Mines (1911)	120
National Research Development Corp v The Wellcome Foundation Ltd (1991)	12–13
Neale v Cottingham (1770)	66
Ngurli Ltd v McCann (1953)	113
NLRB v Bildisco & Bildisco (1984)	63
Official Receiver of Hong Kong v Keith Thomas Philcox (1992)	99
Ord Forrest Pty Ltd v Federal Commissioner of Taxation (1974)	120
Paradis (1934)	50
Penrose, Re (1933)	220
Percival v Wright (1902)	107
Pfizer Inc and Toyama Chemical Co Ltd v Jiwa International (HK) Co (1988)	11
Piercy v Mills (1920)	111, 112
Probe Data Systems Ltd (No 3) (Secretary of State of Trade and Industry v Desai), Re (1992)	151
Produce Marketing Consortium Ltd (No 2) (1989)	127
Quistclose Trust, Re (1970)	162
R v Ahern (1988)	50
R v Allsop (1977)	51
R v Aspinall (1876)	49
R v Bradley (1961)	130
R v Brisac (1803)	50
R v Brockley (1994)	130
R v Campbell (1984)	131
R v Chan Suen Hay (1995)	132

	<i>Page</i>
R v El-Hakkaoui (1975)	45
R v Ghosh (1982)	51
R v Griffiths (1965)	49
R v Hui Wai-bun (1986)	50
R v Jones (1832)	49
R v Lambie (1981)	47, 48–49
R v Liu Po-sing (1986)	45–46
R v Simmonds (1969)	49
R v Sinclair (1958)	51
R v Wai Yu-tsang (1991)	51–52
R v Walters (1979)	50
R v Williams (1942)	218
Ramsay v IRC (1982)	216, 217, 218
Rank Yam Investments Ltd (in liq), Re (1995)	153
Real Estate Development Co, Re (1991)	81, 82
Rex Williams Leisure plc, Re (1994)	139, 140–141, 152
Rolled Steel Products (Holdings) Ltd v British Steel Corp (1986)	113, 170–171
Royal British Bank v Turquand (1856)	3, 156, 159, 162, 166–167, 170, 171, 175, 178
Russo-Asiatic Bank, Re (1930)	61
Scientex Corp v Harry Kay (1986)	99
Scott v Metropolitan Police Commissioner (1975)	51
Sea Fire and Life Assurance Co (Greenwood's case), Re (1854)	161
Securities and Futures Commission v MKI Corp Ltd (1995)	77, 78, 82
Selangor United Estates Ltd v Craddock (No 3) (1968)	107
Sennar, The (No 2) (1985)	86
Sevenoaks Stationers (Retail) Ltd, Re (1991)	128, 142, 144–145, 150
Sharp v Jackson (1899)	72
Smith & Fawcett, Re (1942)	109
Smith Kline & French Laboratories v Attorney General (1966)	10, 11, 12–13
Smith Kline & French Laboratories v Harbottle (1980)	24
Smyth, Leach v Leach, Re (1898)	212
Solomons v Ross (1764)	65–66
Standard Chartered Bank v IRC (1978)	205
Sudeley (Lord) v Attorney General (1897)	212, 213

	<i>Page</i>
Tam Hing-yee v Wu Tai-wai (1991)	68
Teck Corp Ltd v Millar (1972)	108, 112, 114, 115–116
Transvaal Lands v New Belgium (1914)	118
Travel Mondial (UK) Ltd, Re (1991)	146, 154
Treacy v DPP (1971)	45
Tripodi v R (1961)	50
Turquand's case, <i>see</i> Royal British Bank v Turquand	
 Vatcher v Paull (1915)	 112
 W & M Roith Ltd, Re (1967)	 109
Walk Fit Shoes Factory Ltd (in liq), Re (1995)	153
Wallace Smith & Co, Re (1992)	81
Weiner, Wyner v Braithwaite, Re (1956)	212
Weir's Settlement, Re (1971)	214
Welham v DPP (1961)	51
Whitehouse v Carlton Hotel Pty Ltd (1987)	114
Wyllie v Pollen (1863)	163

Table of Legislation

	<i>Page</i>		<i>Page</i>
Hong Kong Legislation		s 4	89
		s 5	93
Bankruptcy Ordinance 1891		s 6	90–91, 92
s 3	95	s 7	76
s 4	89	s 9	91, 94
s 6	92	s 10	91, 94
s 7	91	s 12	88, 93
s 8	91	s 13	93
		s 14	88
Bankruptcy (Amendment) Ordinance 1901 (Ordinance No 2 of 1901)		ss 20–21	93
s 4	92	s 22	93
		s 23	93
Bankruptcy (Amendment) Ordinance 1902 (Ordinance No 6 of 1902)		s 29	88
s 3	92	s 30	94
		s 42	88, 95
		s 43	95
		s 45	88
		s 47	88
		s 49	72, 88
Bankruptcy Ordinance (cap 6)		s 55	96
s 2	91, 95, 97	s 58	93, 95
s 3	88–90	s 99	91

	<i>Page</i>		<i>Page</i>
s 100	94	s 154A	139
s 104	94	s 156	129, 131, 139
s 109	76	s 157B	127
Business Registration Ordinance		s 157C	125
(cap 310)		s 157E	127, 128–129, 131
s 2	186	s 157F	127, 128–129, 131, 135
Companies Ordinance (cap 32)		s 158	137
1932		s 158A	137
s 313	77	s 162	118
Companies Ordinance (cap 32)		s 168C	130, 137
s 1	133	ss 168C–168T	130
s 2	71, 72, 76, 130	s 168D	130, 131
s 4	160	s 168E	129, 130, 132, 134
s 5	171	s 168F	129, 130, 132, 133–134
s 8	166, 169	s 168G	129, 130, 132, 134, 137
s 13	166	s 168H	129, 130, 132, 135–136, 137, 152, 153
s 22	166	s 168I	129, 130, 132, 135, 137, 140, 153
s 28A	159	s 168J	130, 132, 138, 147
s 29	160	s 168K	136, 137
s 48B	119	s 168L	130, 134
s 57A	159	s 168M	131, 133
s 80	164	s 168N	139
s 81	133, 137	s 168O	139
s 95	137	s 168P	132
s 96	137	s 168S	140
s 107	137	s 168T	132, 134
s 108	137	ss 169–227F	74
s 109	137	s 176	71
s 116	166	s 177	73
s 119A	137	s 178	73, 77
s 121	137	s 179	75
s 122	137	s 180	73
s 129B	137	s 180A	71
s 142	138	s 181	73, 79
s 146	138	s 182	72, 136
s 152A	138	s 186	73, 79
s 152B	138	s 190	136
		s 193	74

	Page		Page
s 194	74	Part XI	77, 185–186
s 206	74	First Schedule	127
s 209	73–74	Seventh Schedule	171
s 211	136	Eighth Schedule	193
s 221	73	Twelfth Schedule	130, 133, 134
s 222	73	Fifteenth Schedule	136–137,
ss 228–233	75		147
s 228A	136		
ss 234–239A	75	Companies (Disqualification Or-	
ss 240–248	75	ders) Regulation (cap 32)	
s 241	136	Schedule 1	140
ss 249–257	75	Schedule 2	140
ss 263–296	74, 75	Schedule 3	140
s 265	83		
s 266	72, 136	Companies (Winding-Up) Rules	
s 267	72	(cap 32)	
s 269	72, 96–97	r 58	150
s 275	73, 134, 135, 150		
s 276	150	Conveyancing and Property Ordi-	
s 279	134	nance (cap 219)	
s 300A	136–137	s 20	218
s 300B	137		
s 302	134	Crimes Ordinance (cap 200)	
s 305	164	s 69	52
s 306	134	ss 71–76	52
s 326	72, 76		
s 326–331A	71	District Court Ordinance (cap 336)	
s 327	75, 76–77, 78,	s 52E	68
	79–80, 87, 100		
s 327A	77–78, 79, 86	Estate Duty Ordinance (cap 111)	
s 329	79	s 3	208, 216–217, 219–220
s 330	79	s 5	193, 204, 210, 214
s 331	72, 75, 78, 87, 100	s 6	204, 205, 215,
s 332	72, 78, 186		217, 219, 220
s 341	186	s 7	217
s 351	133	s 10	181, 205, 216, 217, 218
s 358	150	s 14	215
Part IVA	127, 150	ss 34–45	205
Part X	71, 72, 76,	s 35	214–215
	78, 86, 87, 100	s 40	208

	<i>Page</i>		<i>Page</i>
s 43	215	Rules of the Supreme Court (cap 4)	
s 44	220	O 30	67
Schedule 1, Part 22	204	O 44A	67, 68
Schedule 2	205, 214	O 46	67
		O 47	67
Hong Kong Bill of Rights Ordinance (cap 383)		O 48	68
s 8		O 49	67
art 12	132–133	O 49B	68
		O 50	67
Inland Revenue Ordinance (cap 112)		Securities and Futures Commission Ordinance (cap 24)	
s 2	186	s 29A	138–139
s 5	181, 192		
s 8	181, 193	Securities Listing Rules	
s 14	181, 182, 185–190	s 1	125
s 15	191	s 3.08	125–126
s 20A	191, 192		
s 20B	191	Stamp Duty Ordinance (cap 117)	
s 21A	182, 191	s 4	181, 192
Schedule 1	182, 203	s 19	192
Schedule 2	203	First Schedule	181, 192
Inland Revenue Rules (cap 112)		Supreme Court Ordinance (cap 4)	
r 5	186–188	s 20	72
Partnership Ordinance (cap 38)		s 21A	68
s 22	210	s 21B	68
s 41	210	s 21L	67
Registration of Patents Ordinance (cap 42)		Theft Ordinance (cap 210)	
s 6	9, 12	s 27	53
s 7	9–10		
s 8	9		
Registration of UK Patents (Amendment) Ordinance 1968 (Ordinance No 24 of 1968)		United Kingdom Legislation	
ss 7A–7D	10	Bankruptcy Act 1861	
		s 218	91–92
		Bankruptcy Act 1914	
		s 122	59–60, 65, 87, 92, 98

	<i>Page</i>		<i>Page</i>
Companies Act 1948		European Communities Act 1972	
s 5	169	s 9	165, 172
s 188	131		
s 399	79	Finance Act 1959	
		s 35	217
Companies Act 1985			
s 24	160	Firearms Act 1968	
s 35	159, 169, 172	s 16	45
s 35A	159		
s 300	142	Insolvency Act 1985	
s 416	165	s 213	60
s 447	139		
s 711A	165	Insolvency Act 1986	
Part XII	166	s 8	92
Part XXIII	166	s 214	127
		s 220	87
Companies Act 1989		s 265	90
s 3A	172	s 426	60, 92, 98–99
s 35	172–173, 179		
s 35A	172	Land Charges Act 1972	
s 35B	172	s 3	166
s 108	159, 169		
ss 108–112	172	Law of Property Act 1925	
s 142	159, 165	s 198	165
Part IV	155, 156, 160		
Schedule 15	156	Patents Act 1949	
Schedule 16	156	s 21	10
		s 46	10
Company Directors Disqualifica-			
tion Act 1986		Patents Act 1977	
s 6	128, 141	s 1	7
s 7	135	s 4	12
s 8	147	ss 39–43	23
Schedule 1	147	s 60	11
		s 61	11
Co-operation of Insolvency Courts		s 62	11, 13
(Designation of Relevant Countries		s 63	11, 13
and Territories) Order (1986)	99	s 64	11
		s 67	11
Copyright Act 1956		s 69	9, 24
s 5	24		

	<i>Page</i>		<i>Page</i>
s 75	13	International Conventions	
s 130	24	European Patent Convention	
Schedule 1	12	Article 69	12, 18
Patents Etc (Hong Kong) (Convention) Order (1977)	14	Singaporean Legislation	
Theft Act 1968		Companies Act 1990 (cap 50)	
s 15	47	s 25	176
s 21	45		
Australian Legislation		United States Legislation	
Corporations Law		Bankruptcy Act 1898	
s 117	174	s 342	62
s 161	174	Chapter XI	62, 68, 69, 70
s 162	175	Bankruptcy Code (Title 11, USC)	
s 164	175–176	s 101	64, 76
s 229	127, 129	s 303	76, 96, 98
s 230	127	s 304	98
s 592	127	s 1101	62
s 599	127	Chapter 7	98
s 600	128	Chapter 11	63, 84
Canadian Legislation		Internal Revenue Code (Title 26, USC)	
Ontario Business Corporations Act 1982		s 163	198
s 15	176–177	s 482	197
s 17	176–178	ss 861–863	194, 195
s 19	176–178	s 864	194, 197
		s 871	197
		s 882	194, 196, 197
		s 884	196
		s 897	197
		s 1442	194
Chinese Legislation		s 1445	197
Basic Law of the Hong Kong Special Administrative Region of the PRC 1990		s 2105	197
art 139	8	s 6038A	197
		s 6038C	197

Introduction

Charles D. Booth

This is an exciting time to practise commercial law in Hong Kong. With the transfer of Hong Kong's sovereignty to China fast approaching, practitioners are adjusting to many recent changes in commercial law and are awaiting the enactment of further legislative amendments.

This book focuses on current issues and developments in eight areas of commercial law: patents, credit card fraud, transnational insolvency, the oversubscription of securities offerings, the disqualification of company directors, the protection of company creditors, cross-border taxation, and the use of trusts for estate planning. A primary theme of the book is the effect of recent and ongoing law reform on Hong Kong commercial law. Many of the authors discuss proposals by the Law Reform Commission or other bodies. The authors also make their own proposals for improving Hong Kong's legislation and case law.

The call for law reform is not surprising. Much of Hong Kong commercial law has its origins in late nineteenth and early twentieth century English legislation and, until recently, little was done to update it. Hong Kong bankruptcy law is a prime example. Existing law still provides that a creditor must prove that a debtor has committed an 'act of bankruptcy' before a bankruptcy case may be commenced against the debtor. And once debtors have been adjudicated bankrupt, they will normally spend the rest of their lives languishing in bankruptcy, unable to emerge with a fresh start and get on with their lives and new business opportunities. Old principles such as these (which originally regulated the conduct of merchants) have outlived their usefulness. Yet, the Law Reform Commission

has only recently recommended that Hong Kong's bankruptcy legislation be updated. The proposed bankruptcy amendments are but a part of the pre-1997 flurry of commercial law reform.

In the first chapter, Henry Wheare discusses the need to localize Hong Kong patent law, which currently is 'wholly dependent' on UK patent law. At present, only UK patents or European patents designating the United Kingdom are eligible for patent protection in Hong Kong. Wheare highlights this and other weaknesses in the current patent system and then analyses the draft Patents Bill, which incorporates most of the recommendations of the Patent Steering Committee and should be enacted later this year. The proposed legislation provides for the registration in Hong Kong of Chinese patents and, initially, of UK and European granted patents. Wheare notes that the resulting Hong Kong patents will be independent of the original patents and subject to a detailed local patent regime. In his view, the most radical aspect of the draft bill is the proposal to introduce a 'petty patent' system offering short-term protection that is easier to obtain.

In Chapter 2, Clive Grossman QC analyses various types of credit card fraud, many of which are quite intricate. He discusses several practical and legal matters that arise in the prosecution of credit card fraud and urges the reform of Hong Kong's 'cumbersome procedures' regarding the submission of evidence from overseas. He also stresses the need for the credit card industry, applicable law, and law enforcement authorities to continue adapting to the ever-changing nature of credit card fraud.

In Chapter 3, I focus on transnational insolvency law and examine the options available in Hong Kong to a foreign representative who seeks to protect the assets of a foreign debtor in Hong Kong and to obtain cross-border assistance from the Hong Kong courts. I discuss the recognition of foreign insolvencies, non-insolvency options, the winding up of foreign companies, and the bankruptcy of foreign individuals and partnerships. I also examine the ability of Hong Kong trustees and liquidators to seek assistance abroad. Although existing law enables Hong Kong to cooperate in transnational insolvencies, there are many weaknesses and omissions in the current statutory regime. I argue that many of the common law tests are inadequate and suggest that the enactment of detailed statutory guidelines would lead to greater cross-border cooperation and provide more consistency and predictability in the law.

In Chapter 4, I.A. Tokley addresses issues involving the oversubscription of initial public offerings ('IPOs'). He argues that from the perspective of the issuing company, any oversubscription should be viewed as a failure, because an oversubscription of shares results in a notional loss to the company. He sets out the various approaches regarding the responsibility

of directors when issuing some shares at a notional loss and concludes that issuing shares at a notional loss is *prima facie* evidence of an improper use of the power to issue shares.

In Chapter 5, Caroline Hague discusses the recent amendments to the Companies Ordinance regarding the disqualification of company directors in Hong Kong. She notes that the Hong Kong reforms exemplify the trend throughout common law jurisdictions to make directors more accountable for their actions. The Hong Kong enactments are based on the UK Company Directors Disqualification Act 1986, and Hague thus analyses the interpretations of UK courts of the equivalent UK disqualification provisions. Among the issues raised in these cases are what actions constitute 'unfit' behaviour that should lead to a director's disqualification and what mitigating factors may be considered when deciding on a period of disqualification. Hague notes that differences between Hong Kong and the United Kingdom could cause the new disqualification provisions to have less impact in Hong Kong than the corresponding provisions have had in the United Kingdom.

In Chapter 6, Anne Carver argues that existing company law inadequately protects the interests of outsiders when dealing with Hong Kong companies and that there is a growing dysfunctionality between the objectives and the operation of Hong Kong company law. She notes the growing divergence between Hong Kong and UK company law and suggests that the English model for company law is no longer appropriate for Hong Kong. She then focusses on the inadequacy of three areas of Hong Kong law in addressing the needs of the business community — the doctrine of constructive notice, the rule in *Turquand's* case, and the doctrine of *ultra vires*. She concludes with a discussion of two other models for reforming Hong Kong company law. She notes that the Standing Committee on Company Law Reform supports the adoption of changes based on Canadian law, but argues that Australian law would serve as a better model for improving Hong Kong law.

The last two chapters focus on taxation matters. Chapter 7, by Jefferson VanderWolk, discusses the tax aspects of both inbound and outbound trade and investment. In his discussion of inbound trade and investment, VanderWolk stresses that because of the risk of double taxation of income earned in Hong Kong, lawyers should carefully consider the application of the rules, both in Hong Kong and in a foreign entity's home jurisdiction, for determining the source of income subject to taxation by the respective jurisdictions. In his discussion of outbound trade and investment by Hong Kong companies, he notes that tax rates are generally higher abroad than in Hong Kong and discusses why it can be difficult for Hong Kong companies to minimize foreign taxes. VanderWolk

concludes his discussion of tax planning by emphasizing several overriding principles that lawyers should consider when advising on investment schemes with cross-border tax implications.

The final chapter of the book by Andrew Halkyard discusses the legal implications of using trusts for asset protection and estate planning in Hong Kong. This chapter should be of special interest to tax lawyers or commercial lawyers with some tax background. Halkyard explains why an offshore trust is often the best way to mitigate Hong Kong estate duties and analyses the structure of a typical offshore trust in which the units of a unit trust are held by a discretionary trust. He emphasizes the distinctive nature of a beneficiary's interest in a unit trust and suggests how a Unit Trust Deed should be drafted to protect a beneficiary's interest. He also explains why, as a rule, gifts should be avoided when structuring transfers of property to a trust and why the trustee of the discretionary trust must be independent.

As an important commercial centre, Hong Kong has developed a sophisticated body of commercial law, many areas of which are undergoing rapid reform. Of course, every jurisdiction should continually revise its commercial law, if only to keep up with new technology and transactions. In Hong Kong, however, law reform has taken on new importance, as Hong Kong strives to make — as smoothly as possible — the enormous transition from British Colony to Special Administrative Region of China. We hope that these chapters will assist readers in better understanding Hong Kong's commercial law during this period of transition.

Index

- anti-avoidance rules, 197–199
- asset protection, *see* trusts
- Australia
 - corporate income tax, 194n
 - ‘short term patent’ system, 19, 26–28
- Australian Advisory Council on Industrial Property, 28
- Axona International Credit and Commerce Ltd, 96
- Bach, J S
 - payment allegedly made to, 192
- bank cards, 31, 32
- Bank of America, 32, 33
- BankAmericard, 32–33
- bankruptcy, 1–2, 57n, 87–95
- Bankruptcy Act 1861 (UK), 91n, 92n
- Bankruptcy Act 1898 (US), 62, 68
- Bankruptcy Act 1914 (UK), 59n, 60n, 65n, 87n, 92n, 98n
- Bankruptcy (Amendment) Bill 1996, x
- Bankruptcy (Amendment) Ordinance 1902, 92n
- Bankruptcy Code (US), 62n, 63, 64n, 76, 84, 96, 98
- Bankruptcy Ordinance 1891, 89n, 91n, 92n, 95n
- Bankruptcy Ordinance, 56, 72n, 76n, 88–95, 97
- Bankrupts
 - undischarged, 129–30
- Basic Law
 - provision for SAR to protect patents, 8n
- Berne Union, 14
- Business Registration Ordinance, 186
- Canada
 - credit card fraud in, 37
 - personal income tax, 203n
- capital duty, 184, 193
- capital gains, 181–182, 191
- carrying on a trade or business
 - determination of, 185–188, 195
- charge cards (*see also* credit cards), 31, 32
- China
 - application of international patent conventions to Hong Kong, 14
 - corporate income tax, 194n
 - counterfeit credit card manufacture in, 36
 - intellectual property laws, 29

- joined Patent Cooperation Treaty, 15
 - member of Paris Convention, 15
 - patent protection for nationals of, 15
 - patent system, 28–29
 - territorial approach in transnational insolvency case, 99–100
 - China Tianjin International Economic and Technical Co-operative Corporation, 82n
 - Chinese language
 - patent applications in, 19
 - Community Patent Convention, 20, 23–24
 - companies (*see also* protection of outsiders)
 - investigation of, 138–139
 - Companies Act 1948 (UK), 79, 131, 169
 - Companies Act 1985 (UK), 121n, 139, 142, 147n, 158, 159n, 160, 165, 169n, 172
 - Companies Act 1989 (UK), 155n, 156n, 158, 159n, 160, 165, 169n, 171, 172–173, 179
 - Companies (Amendment) Bill 1991, 126
 - Companies (Amendment) Bill 1996, x
 - Companies (Amendment) Ordinance 1994, 127
 - Companies (Amendment) (No 2) Ordinance 1994, 138
 - Companies Ordinance 1865, 76
 - Companies Ordinance 1911, 76
 - Companies Ordinance, 72n, 83n, 96, 97, 118n, 119n, 159n, 160, 164n, 166n, 169, 171, 185, 186, 193n
 - directors' duties, 125
 - disqualification of company directors, 3, 127, 128–129, 130–140, 147, 150n, 152, 153n
 - proposed amendment of, 76, 86–87, 100–101, 176
 - review of, 155
 - winding up, 56, 62, 71, 72n, 73, 74n, 75–80
- Companies (Single Member Private Limited Companies) Regulations 1992 (UK), 160
 - Company Directors Disqualification Act 1986 (UK), 3, 127–128, 135n, 141, 142, 144, 147, 158
 - Company Directors Disqualification Unit, 154
 - company law, 3
 - approaches to reform, 179
 - Australian model, 174–176
 - Canadian model, 176–178
 - divergence between Hong Kong and United Kingdom, 157–161
 - objectives, 155, 156
 - reform in
 - Hong Kong, 158–159
 - United Kingdom, 158, 179
 - United Kingdom model, 172–173
 - 'consignment tax', 192
 - conspiracy
 - in credit card fraud, 44, 47, 49–51
 - constructive knowledge, *see* constructive notice
 - constructive notice
 - doctrine of, 3, 156n, 159, 162–167, 170, 171
 - abolished in Canada, 178
 - Convention for the Protection of Industrial Property, *see* Paris Convention
 - Copyright Ordinance, 7
 - Cork Report*, 1982, 158
 - corporate governance, 126
 - corporate income tax, 194
 - Corporations Law (Australia), 127n, 128n, 129n, 174–176
 - counterfeiting
 - credit cards, 36–38
 - credit card fraud, 2, 31–54
 - acquirer fraud, 41
 - applications, 38, 42
 - conspiracy, 44, 47, 49–53
 - counterfeiting, 36–38, 40, 42
 - investigation, 43–52
 - jurisdiction and, 44–47
 - 'lending', 38

- losses from, 34, 37, 40, 41–42
- lost cards, 35, 42
- manual alteration, 35
- measures against, 37
- mens rea* and, 51–52
- merchant collusion, 35
- overseas evidence in, 43–44, 53
- ‘points of compromise’, 36, 37
- presentation of fake cards, 47–49
- prosecution of, 52–53
- ‘shave and paste’, 35
- stolen cards, 34–35, 42
- telecommunications and, 39
- telemarketing and, 39
- ‘white plastic’, 35–36, 43
- Credit Card Fraud Act 1984 (US), 37
- credit cards, 47
 - history, 31–33
 - impact of technology on, 39
 - security, 37, 40, 53
 - transactions, 33–34
- Crimes (Amendment) Ordinance 1992, 52
- Crimes Ordinance, 52, 53
- Criminal Justice Act 1987 (UK), 147n
- cross-border insolvency, *see* transnational insolvency
- cross-border trade and investment (*see also* foreign trade and investment)
 - lawyers to be aware of tax issues relating to, 183, 200
 - tax systems perceived as obstacle to, 182
- Crown debts, 146–147, 153
- Crowther Report on Consumer Credit*, 1971, 158
- Deak, R. Leslie, 85
- Deak Perera (Far East) Ltd, 84–86
- Denway Ltd, 106, 119n
- Diamond Report*, 1989, 158
- Diners Club, 32
- directors
 - accountability of, 3
 - action against
 - avoidance of, 123–124
 - for breach of duty, 122
 - breach of duty by, in IPO, 118
 - conflict of interest, 117–118, 126
 - corporate, 139
 - disqualification of, *see* disqualification
 - distinction between *bona fide* intent and proper purpose, 113–117
 - duties, 125
 - codification of, 122
 - duty of care, 108, 127
 - duty of skill, 108, 126
 - duty to act in good faith, 108–111, 126
 - exercise of powers for proper purpose, 111–113, 126
 - fiduciary duties, 107, 108, 126
 - improper use of power to issue shares, 122
 - maintain proper accounting records, 146
 - misuse of powers, 171
 - responsibility when issuing shares, 107–118
 - shadow, 135, 137–138
 - strict liability, 149
 - ultra vires* acts, 168
- disqualification (of company directors) (*see also* Companies Ordinance; Company Directors Disqualification Act 1986 (UK)), 125–154
 - competence of directors, 142–145
 - corporate directors, 139
 - differences between Hong Kong and United Kingdom, 153–154
 - grounds for
 - breach of Companies Ordinance, 133–134
 - breach of fiduciary duties, 147
 - conviction of indictable offence, 132
 - fraud, 134–135
 - negligence, 149
 - unfit director of insolvent company, 129, 130, 135–137, 141
 - unfitness to act as director, 128, 138, 141–147

- mitigating factors, 148–149
- orders
 - application for, 132, 138
 - breach of, 131, 139
 - effect of, 130–131
 - form of, 140
 - made in United Kingdom, 128, 141
 - procedures on application for, 149–151
 - reports on conduct, 140
 - rules for service, 140
 - striking out application for, 151–152
- personal liability for company debts, 139
- previous legislation on, 128–129
- regulations, 130, 140–141
- shadow directors, 135, 137–138, 140
- undischarged bankrupts, 129–30, 139
- domestic agent, 195
- English language
 - patent applications in, 19
- entertainers, non-resident, 191–192
- Equity Joint Stock Companies Registration and Regulation Act 1844 (UK), 161
- estate duty, 184, 193
 - anti-avoidance provisions, 205
 - associated operations, 216–217
 - controlled companies
 - liability to duty of, 205–206
 - liquidation of, 214–215
 - estate planning, use of trusts for, 203–204, 206–221
 - gifts, liability to duty of, 205, 215, 217, 220
 - introduction to, 204–206
 - offshore property, exemption from, 205, 217n, 218
 - use of trusts to mitigate, 4
- Estate Duty Ordinance, 181n, 193n, 204n, 205, 208, 210, 214–220
- European Asia Bank v Reicar Investments Ltd*, 169–170
- European Communities Act 1972 (UK), 165, 172
- European Community Directive on Company Law
 - influence on United Kingdom legislation, 157, 159–160, 172
- European Patent Convention, 12, 14, 15–16, 18, 19–20, 24, 25
- evidence
 - in credit card fraud, 43–44, 53
- Financial Services Act 1986 (UK), 147n
- Firearms Act 1968 (UK), 45
- ‘fiscal nullity’
 - doctrine of, 198
- foreign companies (*see also* unregistered companies)
 - winding up, 75–87
- foreign insolvencies
 - recognition of, 59–64, 65
- foreign representative
 - options available to, in transnational insolvencies, 65–95
- foreign taxation
 - of non-resident corporations, 194–199
- foreign trade and investment
 - by Hong Kong companies, tax aspects of, 193–199
 - in Hong Kong, tax aspects of, 184–193
- France
 - patent protection in, 19
- Franklin National Bank, 32
- fraud, *see* credit card fraud
- Gift Duty Assessment Act (Australia), 120
- Hong Kong
 - credit card fraud in, 34–43, 45–47, 53–54
 - insolvency in, 55–56, 153
- Hong Kong Bill of Rights Ordinance, 68n, 132n, 133n, 153n

- Hong Kong Philharmonic Orchestra
alleged payments to deceased
composers by, 192
- Hong Kong Special Administrative
Region (SAR)
establishment of, 6,8
transition to, 4
- IBANCO, 32, 33
- import duty, 184
- Independent Commission Against
Corruption (ICAC), 36
- Indonesia,
tax treaty, 199
- initial public offerings (IPOs)
oversubscription, 2, 103–124
- Inland Revenue Department
practice note on
locality of profits, 192
profits arising in Hong Kong, 190
- Inland Revenue Ordinance, 181n,
182n, 185–190, 191n, 192, 193n,
194, 195, 203n
- insolvency (*see also* transnational
insolvency)
in Hong Kong, 55–56, 153
- Insolvency Act 1985 (UK), 60n, 87n
- Insolvency Act 1986 (UK), 60n, 90n,
92n, 98, 99n, 127, 158
- intellectual property, 5, 29
- Intellectual Property (World Trade
Organisation Amendments) Bill
1995 (UK), 10n
- Internal Revenue Code (US), 194n,
195n, 196n, 197n, 198n
- investment, *see* cross-border trade and
investment; foreign trade and
investment
- Irish Rowan* (ship), 80
- Japan
corporate income tax, 194
- Jenkins Report*, 1962, 158
- Joint Stock Companies Act 1856 (UK),
162
- Joint Working Party of the Securities
and Futures Commission and the
Stock Exchange of Hong Kong, 104,
105–106
- jurisdiction
bankruptcies, 89–95, 100
credit card fraud, 44–47
tax planning, 184, 200
winding up foreign companies, 79–
83
- law reform
bankruptcy, 2, 89n, 90n, 94
commercial, 1, 4
company, 86–87, 100–101, 158–
159, 165, 176, 177, 179
patent system, 8, 17–28
- Law Reform Commission, 2, 89n, 90n,
93, 94
report on bankruptcy, 56
- lawyers
role in taxation and tax planning,
183–184
- lease payments, 191
- Limited Liability Act 1855 (UK), 162
- Limited Partnership Ordinance, 76
- liquidation, *see* winding up
- liquidators
ability to seek assistance in trans-
national insolvencies, 95–101
- Macau
counterfeit credit card manufacture
in, 36
- Malaysia
corporate income tax, 194n
- MasterCharge, 32
- mens rea*
in credit card fraud, 51–52
- National BankAmericard Inc, 32
- Netherlands
tax treaties, 199
- Ontario Business Corporations Act
1982, 176–178
- Paris Convention, 14–15, 27
- Partnership Ordinance, 210

- Patent Cooperation Treaty, 14, 15–16, 24
- Patent Steering Committee, 8
 - report, 8, 17–19
- patent system
 - application of international conventions to Hong Kong, 14–16
 - dependent on United Kingdom, 8, 9
 - effectiveness of, 10–13
 - localisation, 17–18
 - present system in Hong Kong, 9–10
 - reform of, 8, 17–28
- patents
 - applications filed internationally, 6
 - limited interest in, protection in Hong Kong, 6–7
 - nature of, 6
- Patents Act 1949 (UK), 11, 12
 - Crown user provisions, 10
- Patents Act 1977 (UK), 7n, 9, 11, 12, 13, 20, 23, 24, 25
- Patents Bill, 2, 5–6, 8
 - provisions
 - amendment of patent, 23
 - applications, 20
 - employee's inventions, 23
 - formal requirements, 21–22
 - infringement, 23–24
 - maintenance of patent, 22
 - request for registration and grant, 22
 - revocation, 25
 - right to apply, 21
 - 'short term patent', 2, 19, 26–28
 - surrender of patent, 22
 - threats, 25
 - time limits, 20–21
 - transition to SAR, 25–26
 - validity, 25
- 'permanent establishment', 186–188, 195
- Prentice Report*, 1986, 158, 165, 172
- Privy Council
 - failure to elucidate proper use of directors' powers, 112
- profits
 - arising in or derived from Hong Kong, 188–190
 - subject to withholding tax, 191–192
 - taxation of distributed corporate, 196
- profits tax, 184, 194, 196
 - basis for charge to, 185–190
- property tax, 184, 192
- protection of outsiders, 156
 - actual knowledge, 163
 - Australian approach, 174–176
 - Canadian approach, 176–178
 - constructive knowledge, 163–166, 167
 - doctrine of *ultra vires*, 168–173
 - history of law on, 161–162
 - implied knowledge, 163
 - rule in *Turquand's* case, 162, 166–167
- real property
 - tax on sale of, 197
- records (company)
 - inspection of, 138
 - maintenance of accounting, 146
 - production of, 138–139
- Registration of Patents Ordinance, 9–10, 11, 12, 14
- Report of the Company Law Division Committee, Second*, 1973, 158
- Report of the Standing Committee on Company Law Reform, Ninth*, 1992, 158
- Report on Bankruptcy*, 1995, 56
- Report on Reform of the Hong Kong Patent System*, 1993, 8, 17–19, 23, 26
- representative office
 - effect on tax liability, 188, 195
- Roethenmund, Otto Emil, 85
- royalties, 191
- salaries tax, 184, 193
- sale of goods, 191, 192
- Securities and Futures Commission, 122
- Joint Working Party, 104, 105–106

- Securities and Futures Commission (Amendment) Ordinance 1994, 138–139
- Securities (Disclosure of Interests) Ordinance, 125
- Securities (Insider Dealing) Ordinance, 125
- Shanghai Petroleum Company, 103
- share capital
 - loss of, 118, 121–122
 - nature of, 119–122
- shares
 - creation of market in, 115, 117
 - directors' responsibility when issuing, 107–118
 - initial public offering, 103–124
 - interest on application payments, 118–119
 - issue at notional zero value, 115, 117, 122
 - offer price, 104–107, 115
 - oversubscription, 103–124
- 'shave and paste'
 - credit card fraud, 35
- Singapore
 - corporate income tax, 194
 - tax treaty, 199
- Sino-British Joint Liaison Group, 6
- source-of-income rules, 195
- sportsmen, non-resident, 191
- stamp duty, 184, 192
- Stamp Duty Ordinance, 181n, 192n
- Standing Committee on Company Law Reform, 3, 158, 165, 171, 173, 176, 177
- Stock Exchange of Hong Kong, The
 - Joint Working Party, 104, 105–106
 - rules relating to directors, 125
- Supreme Court Ordinance, 67n, 68n, 72n
- Taiwan
 - corporate income tax, 194
 - counterfeit credit card manufacture in, 36
- tax incentives, 196–197
- tax planning, 182–183, 184, 190, 198, 199–201
- tax rates
 - foreign, 183, 194, 203
 - Hong Kong, 182, 203
- tax treaties, 199
 - Hong Kong not a party to, 183, 194–195
- taxation, 3
 - anti-avoidance rules, 197–199
 - corporate dividends, 196
 - double, 182
 - enforcement, 182
 - importance of, to investors, 182–183
 - liability in
 - foreign jurisdictions, 193–199
 - Hong Kong, 184–193
 - system in Hong Kong, 181–182
- telecommunications
 - credit card fraud in, 39
- telemarketing
 - credit card fraud in, 39
- Theft Act 1968 (UK), 45, 47
- Theft Ordinance, 53
- Tose, Philip, 103
- trade, *see* cross-border trade and investment; foreign trade and investment
- Trade Descriptions Ordinance, 7, 24
- Transfer of Businesses (Protection of Creditors) Ordinance, 154
- transfer pricing rules, 197
- transnational insolvency, 2, 55–101
 - ancillary
 - bankruptcy, 84, 94, 95
 - winding up, 83–84, 86–87
 - approaches to resolving, 57–59
 - bankruptcy, 87–95
 - concurrent
 - bankruptcy, 84, 94, 95
 - insolvency, 83, 84, 86
 - winding up, 83, 84, 86
 - foreign insolvencies, recognition of, 59–64, 65
 - foreign representatives, options available to, 65–95

- Hong Kong trustees and liquidators,
 - assistance to, 95–101
 - impact on Hong Kong, 56
 - non-insolvency options, 65–71
 - winding up, 71–87
- trustees
 - ability to seek assistance in transnational insolvencies, 95–101
- trusts, 4
 - analysis of typical structure, 208–221
 - asset protection, use of trusts for, 203
 - competency to dispose, need to avoid, 219–220
 - discretionary
 - designation of protector under, 207
 - flexibility, 207
 - letter of wishes for, 207
 - nature of beneficiary's interest in, 213–214
 - preferred for estate planning, 213
 - trustee to be independent, 220
 - estate planning, use of trusts for, 203–204, 206
 - typical offshore, structure, 206–207
- unit
 - nature of beneficiary's interest in, 209–212
 - not a company, 208
 - sole unit holder in, 219
- Turquand's case*, 3, 156n
 - Australian position on rule in, 175–176
 - rule abolished in Canada, 178
 - rule in, 159, 162, 166–167, 170, 171
- ultra vires*
 - doctrine of, 3, 156n, 158, 162, 167, 168–173
 - in the narrow sense, 168–169
 - in the wider sense, 170–172
- rule
 - abolished in company law in Canada, 176–178
 - altered by European Directive on Company Law, 159
 - Australian approach to, 174–176
- Union Bank of Australia, 164
- United Kingdom
 - corporate income tax, 194n
 - recognition of Hong Kong insolvencies, 98–99
- United States
 - corporate income tax, 194n
 - credit card fraud in, 35, 37
 - personal income tax, 203n
 - recognition of Hong Kong insolvencies, 99
 - sale of foreign owned real property taxed in, 197
 - telemarketing fraud in, 39
- Universal Copyright Convention, 14
- unregistered companies
 - definition, 76
 - proposed amendment of, 86
 - winding up of foreign companies as, 76–78
- Visa Card, 33, 40
- Visa International, 33
- Western Union
 - first charge card issued by, 31
- 'white plastic'
 - credit card fraud, 35–36, 43
- winding up
 - advantages, 72–73
 - ancillary assistance, 83–84, 86–87
 - companies in Hong Kong, 71–74
 - foreign companies, 75–87
 - unregistered companies, 76–78
- withholding tax, 191–192, 194
- World Intellectual Property Organisation (WIPO), 14