

Newsletter Nr. 177 (EN)

**How to Inherit Shares in a Hong Kong Company
and Enforce Certain Shareholder Rights**

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I. Introduction

The loss of a loved one is always emotionally difficult. However, when the deceased was a corporate shareholder then their passing can lead to legal and business difficulties as well. This newsletter is designed to provide some introductory information about:

- How to enforce the right to inherit shares in the company;
- How to register as a replacement shareholder;
- How to obtain company information from the other shareholders; and
- The liability of the other shareholders for failing to disclose company information.

II. Case Study

The information provided in this newsletter shall be based on the following case study.

In the underlying scenario, we assume that the father of our client (the “**Client**”) died several years ago. The deceased set up a Hong Kong company (the “**Company**”) with a business partner (the “**Defendant**”), and the Defendant is acting as the director of the Company. The deceased is still registered as a shareholder of the Company. The Client, deceased and Defendant are all German nationals.

The Client wants to inherit the shares from the deceased and become a shareholder of the Company. However, the Defendant refuses to disclose any information about the Company. The Client obtained a judgment

from a German court which ordered the Defendant to disclose all relevant information to the Client. However, to date, the Client has not received any information from the Defendant.

The abovementioned scenario raises several problems:

- Can the Client inherit shares in the Company?
- If so, how does the Client register as a shareholder?
- What are the Client’s rights to information and what happens if the Defendant refuses to provide such information?
- How can a German judgment be enforced in Hong Kong?
- In which circumstances will a director (i.e. the Defendant) be liable?
- What are the legal consequences to the Defendant if he intentionally harms the Company?

III. Legal Solutions

1. Can the Client inherit shares in the Company?

a) Right to inherit shares from the deceased

According to Cap 622 Companies Ordinance, Section 153, if the deceased was the holder of the shares, then the personal representative i.e. the executor or the administrator of the deceased’s estate can validly

transfer the shares as if the personal representative had been the registered holder of such shares.

As part of his duties in distributing the deceased's estate, the legal personal representative will identify the relevant beneficiary of the shares (either under a will or the intestacy rules). The beneficiary, i.e. the Client, may choose to either register as a shareholder himself or appoint a nominee.

Upon registration, the Client will have all the same shareholder rights as the deceased had. It is therefore essential for the Client to complete the registration process as soon as possible. However, the director of the Company, i.e. the Defendant, retains the right to decline or suspend registration.

b) Right of directors to refuse registration/transfer of shares

According to Cap 622H Companies (Model Articles) Notice (Schedule 1, Section 81, Schedule 2, Section 64) and Section 151 (2) Companies Ordinance, the Defendant has the right to refuse to register a new shareholder or share transfer. In such case, the company must send the Client a notice of refusal within two months after receiving the notification and, upon the Client's request, the Defendant must provide a statement of reason. If no such statement of reason is provided within 28 days of the request, the Company commits an offence and is liable to a fine at level 4 (HKD 25,000) and commits a continuing offence which leads to a further fine of HKD 700 for every day in breach of the provision. If the Company still refuses to register the shares, then the Client can apply to the court who will subsequently order the registration to occur (Section 152 Companies Ordinance).

2. If so, how does the Client register as a shareholder?

For the purposes of this section, we assume that the Client has been appointed as executor under the deceased's will or is acting as the administrator of the deceased's estate.

a) File documents with the Inland Revenue Department

If the deceased died before 11 February 2006, then the Client must file an application with the Hong Kong Inland Revenue Department ("IRD") in order to obtain estate duty clearance. If the deceased's assets are worth less than HKD 7.5 million, then they will not incur estate duty, but filing the documents with the IRD is still required.

The IRD dossier must include:

- Death Certificate;
- Deceased's identity card/passport/ or other legal documents which can prove his identity;
- Applicant's identity card/passport;
- The Affidavit for the Commissioner (obtained from the IRD);
- Documents related to the assets and liabilities of the estate (i.e. the Company's financial statements). If such documents cannot be acquired, other equivalent documents can be submitted instead, e.g. annual returns. Preferably, the documents should be dated within the 3 years prior to the death of the deceased. The IRD has the power to ask for more documents from the Company if they see fit;
- Documents to prove the relationship between the applicant and the deceased; and

- The original will (if any).

Any documents which were issued abroad must be legalized in their country of origin (see below for Authentication of Documents). For example, documents may be sealed by a German court. Any documents which are not in English or Cantonese must be translated.

b) Apply for a probate grant at the Probate Registry

After receiving the estate duty clearance from the IRD, the Client should apply to the Probate Registry to grant a letter of probate in Hong Kong. He should provide the following documents along with the specific forms:

- Any proof issued by the German court that the Client is entitled to inherit the deceased's assets;
- Death certificate or a certified copy legalized with the Certificate of Apostille in Germany;
- Original will and a certified copy thereof;
- Birth certificate of the deceased (original or certified copy), if available;
- Estate duty clearance obtained from the IRD; and
- Applicant's identity documents.

Again, all documents must be legalized in Germany or the applicable foreign country. If all the documents are well prepared, then it will normally take 2 months for the Probate Registry to process the grant.

c) Authentication of Documents

All the documents mentioned above, which are necessary on the application to the IRD

and the Probate Registry, must be legalized in the country of origin. For the purpose of this case study, this would be Germany.

Since both Germany and Hong Kong signed The Hague Convention (*Convention of 5 October 1961 Abolishing the Requirement of Legalisation for Foreign Public Documents*), a "legalized" document is simply one which has a Certificate of Apostille attached. The Certificate of Apostille proves that the document is authentic and was issued by the applicable court or administration authority. This certificate is recognized by signatories to the Hague Convention.

Therefore, the Client must obtain a Certificate of Apostille for both the deceased's death certificate and birth certificate.

d) Transmission of shares

After the Probate Registry has issued the grant, the estate will be distributed and the Client (as the beneficiary under the will or under the intestacy rules) will be entitled to register the shares. The act of registering shares upon the death of a shareholder is called a transmission of shares.

The Client may choose to be registered as a member (shareholder) of the Company, or may transfer the shares to another person.

If the Client chooses to register the shares in his name, he may (if the articles of association of the Company permit) request the Company to enter his name in the register of members by submitting to the Company a letter of request. Alternatively, he can present to the Company for registration a stamped instrument of transfer transferring the shares to the Client's own name.

If the Client chooses to transfer the shares to a third person, he must sign an instrument of transfer as transferor in his capacity as an executor or administrator of the deceased's estate.

According to Cap 622 Companies Ordinance, Section 161, the Company and its director are bound to accept as sufficient evidence of the grant of probate of the will or letters of administration of a deceased person the production of a document that is by law sufficient evidence of that grant.

The transmission of shares should be reported in the next Annual Return to the Companies Registry. In practice, if the grant of probate is in progress, one may also state in the Annual Return that the original shareholder has died and the grant of probate is in progress.

3. What are the Client's rights to information and what happens if the Defendant refuses to provide such information?

a) Criteria to acquire information by court order

If the Client has a valid claim that he intends to pursue at the Court of First Instance (claim exceeding HKD 1 million), then he can apply for pre-action discovery of information from the potential Defendant under Sec. 47A District Court Ordinance. The requirements for such an application are:

- The proceeding is very likely to happen;
- The subsequent claim will be submitted to the Court of First Instance, and will exceed HKD 1 million;
- The documents are directly relevant to the case and they are in possession of the potential Defendant; and
- The Court thinks it is appropriate to grant such an application.

b) Conclusion

Please note that until the Probate Registrar issues the grant of probate, the Client will not be regarded as having officially inherited the shares and will consequently have no claim against the Defendant.

4. How can a German judgment be enforced in Hong Kong?

a) Time limitation

According to *Foreign Judgments (Reciprocal Enforcement) Ordinance [Cap 319, section 4 (1)]*, a Hong Kong court will not recognize or execute any foreign judgments if more than 6 years have elapsed since the date of judgment.

b) Requirements of the German judgment

According to *Conflict of Law in Hong Kong (Graeme Johnson)*, there are six requirements to enforce a German (or any other foreign) judgment in Hong Kong:

- The German judgment must not be against natural justice. That is, in obtaining the German judgment, the Defendant must have had an opportunity to present his case before the court. Further, the judgment must not have been obtained by fraud;
- The Defendant must have been present/residing in Germany at the time the original proceedings commenced (to prevent forum shopping). If the Defendant is a company, then Germany should be its fixed place of business or the location from where the business of the Company is managed;
- The German judgment must be final, meaning that there must not be any pending proceedings in Germany;

- The case must not be tried in Hong Kong or other countries by the same parties;
- The German judgment must not conflict with any Hong Kong case law; and
- The German judgment must not be contrary to Hong Kong's public policy ("Ordre Public").

c) Conclusion

Assuming that the Defendant was a resident of Germany at the beginning of the original proceedings and the German judgment meets all the abovementioned criteria, it is likely that a Hong Kong court will recognize and enforce the German judgment.

5. In what circumstances will a director (i.e. the Defendant) be liable?

a) Director fails to conduct the annual general meeting

According to Cap 622 Companies Ordinance, Section 610 (9), a shareholder may report the director's failure to conduct the annual general meeting for each financial year to the court. The court may then order the director to schedule the meeting. If the director still fails to conduct the meeting, the court may order the director to pay a fine.

b) Director fails to convene extraordinary general meetings

According to Cap 622 Companies Ordinance, Section 566 (1), (2), a company must convene an extraordinary general meeting upon request of any shareholder(s) who hold(s) more than 5% of the company's paid-up capital. As stipulated in Section 568, shareholders who requested the meeting, or any of them representing more than half of the total voting rights, have the power to call the meeting if the director fails to do so.

The directors must repay and reimburse the company for any reasonable expenses which result from the failure to conduct the meeting. Reasonable expenses include, for example, the fees of facilities or remuneration of services which has been wasted as the result of failing to conduct the meeting.

6. What are the legal consequences to the Defendant if he intentionally harms the Company?

a) Disqualification of the directors

A director may be disqualified under a court order if:

- The director is convicted of a criminal offence in connection with his company in regards to which he has acted fraudulently or dishonestly (Cap 32 Companies (Winding Up and Miscellaneous Provisions) Ordinance, Section 168E (1));
- The director is in persistent default of the Companies Ordinance, i.e. the director fails to return, file, or deliver any documents required by the Companies Ordinance more than three times in five years (Cap 32 Companies (Winding Up and Miscellaneous Provisions) Ordinance, Section 168F (2), (3)).

A court order to disqualify a director may be requested by (i) the Companies Registry, or (ii) any past or present member of the company (Cap 32 Companies (Winding Up and Miscellaneous Provisions) Ordinance, Section 168P).

In the case of *Re GP Nanotechnology Group* [2009] HKEC 1677, two directors were disqualified by the court, and banned from acting as a director of any other corporation for six years. The directors were disqualified because they were responsible for the execution of five extraordinary transactions which continuously drained funds out of the

company without any proper purpose. The transactions were plainly not in the company's interest.

b) Obtain compensation from the directors

A director has a fiduciary duty to act for the benefit of the company and to exercise his powers for proper purposes.

Assuming that the director (i.e. the Defendant) had intentionally withdrawn money from the Company, or had caused financial harm to the Company or any shareholder (i.e. the Client), then the injured party may claim for any financial damage or loss which was caused by the director's (Defendant's) acts.

In addition, if the Defendant used the Company to make a personal profit without

paying any fees or accounting for the transaction to the Company, then the Client may make a claim for the said wrongfully gained profit.

In the case *Industrial Development Consultants v Cooley* (1972) 1 WLR 433, the defendant obtained information and knowledge about an industrial project through his position as a director of Industrial Development Consultants. The director then resigned from his position and used the information to make a large amount of personal profit. Industrial Development Consultants then sued the former director and successfully claimed the personal profit.

*We hope that the information provided in this brochure was helpful for you.
If you have any further questions please do not hesitate to contact us.*

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