Commercial Law Review – Summer 2026

The Commercial Unit, Civil Division
The Department of Justice

What's inside

Editorial

This edition features three articles and three case reports.

The first article provides an overview of the concept of set-off, under which mutual debts between parties are netted against each other. It identifies five main types of set-off: contractual set-off, which arises from party agreement; statutory insolvency set-off, which applies automatically on insolvency; legal set-off, a procedural defence that requires mutual and liquidated claims; common law set-off, which permits a reduction in the contract price for defective performance; and equitable set-off, which allows deduction of closely connected cross-claims where it would be unjust to enforce the claim without accounting for the cross-claims.

The second article examines the distinction between contractual and statutory obligations. Contractual obligations stem from agreement and are generally subject to the doctrine of privity, while statutory obligations are imposed by legislation and can apply independently of the parties' consent. The article also discusses how statutes may modify contractual relationships by implying terms, extending rights, or imposing additional liabilities.

The third article offers a clear overview of the essential features of charitable trusts under Hong Kong law. It highlights their key advantages, notably tax exemptions and the court's power under the cy-près doctrine to modify or preserve a charitable trust when its original purposes become impossible or impracticable to fulfil.

The first case considered whether a taxpayer company was chargeable to profits tax under s.14 of the Inland Revenue Ordinance (Cap. 112) on the basis that it was carrying on business in Hong Kong and deriving profits from that business. The judgment illustrates that the mere existence of a business presence in Hong Kong does not automatically render all profits derived from that business subject to Hong Kong profits tax.

In the second case, the Court of Appeal clarified the threshold requirement for winding up a foreign company in Hong Kong—namely, the need to show a reasonable possibility of benefit to the petitioners. The court held that neither the mere presence of the company's assets in Hong Kong nor the availability of broader statutory powers for a liquidator was sufficient, in itself, to satisfy this requirement.

The third case examined whether a breach of a liquidity obligation under "Keepwell Deeds" gave rise to actionable loss. The obligation required the provider to supply liquidity to enable the issuers and guarantors (the claimants) to meet their payment obligations under certain bonds. The Court of Final Appeal held that the obligation could be satisfied by making a loan to the claimants. Any benefit received would therefore be offset by a corresponding repayment liability, resulting in no net loss. Consequently, only nominal damages were recoverable.

Boyce Yung

Introduction

When two parties are mutually indebted, it is common for them to net those amounts against each other for administrative convenience, rather than exchanging full payments. This practice involves the concept of set-off.

While the right of set-off can be created by a contract or statute, the courts also recognise three other types of set-off, namely: legal set-off, set-off developed at common law, and equitable set-off, which are created by the operation of law or equity.[1]

This article gives an overview of the five types of set-off and their governing principles.

Types of Set-off

(a) Contractual set-off

Contractual set-off is created by an explicit agreement between parties to net their mutual debts. The scope and operation of the set-off depend on the precise construction of the specific set-off clause. For such a clause to be effective, it should be drafted in clear and unambiguous language.

For example, standard terms and conditions in government tender templates for both the supply of goods[2] and the provision of services[3] contain a set-off clause. In essence, such a clause provides that if a contractor incurs any liability to the Government under any contracts, the Government has the right to set-off the amount of that liability against any sum due (or which may become due) from the Government to the contractor under any other contracts between them.

(b) *Statutory insolvency set-off*

Insolvency set-off, being one of the statutory set-offs, is provided under s.35 of the Bankruptcy Ordinance (Cap. 6) and imported into s.264 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32). It applies automatically from the date an individual is adjudged bankrupt or a company is wound up and cannot be contracted out of[4].

This type of set-off allows mutual debts between a creditor and an insolvent party to be set-off against each other, leaving only the net balance to be claimed from, or paid to, the insolvent estate. Without insolvency set-off, a creditor dealing with an insolvent party would have to pay his debts owed to the insolvent party in full before being entitled to share the insolvent party's remaining assets with other creditors on a *pari passu* basis, which could often be nil or nominal in reality.

To invoke insolvency set-off: (i) there must be mutual claims, such as mutual credits, debts, or other dealings between the same persons and in the same right[5]; (ii) these mutual claims must exist at the date of presentation of the bankruptcy or winding-up petition to be provable against the debtor; and (iii) at the time of extending the credit to the debtor, the creditor must not have had notice that a bankruptcy or winding-up petition had been presented.[6]

(c) Legal set-off

In the context of litigation, legal set-off acts as a specific procedural defence.[7] It allows a defendant to assert a cross-claim against a plaintiff who is also indebted to him within the same action, saving the defendant the time and costs of commencing a separate action.

To establish a legal set-off: (i) both the plaintiff's claim and the defendant's cross-claim must be liquidated (or capable of being ascertained with precision) as at the date of the pleading; and (ii) the claims must be mutual, meaning that they must exist between the exact same parties acting in the same legal capacity.[8] While mutuality is required, the claims do not need to be connected or arise from the same transaction.[9]

For instance, in *Alco International Ltd. v Akai*

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[1] *Karpex (HK) Ltd v Yasmine Printing (China) Ltd* [2008] 1 HKLRD 199 at §10; Commentary 18/17/2 of the Hong Kong Civil Procedure 2026.

[2] Clause 17 of the General Conditions of Contract ("**GCC**") of BD-TERMS-1 (January 2026).

[3] Clause 13 of GCC of BD-TERMS-2 (January 2026).

[4] *Re Guy Kwok-hung Lam (林國雄)* (2023) 26 HKCFAR 119 at §65.

[5] *National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785 at p. 821F.

[6] *Alan C.W. Tang v John J. Toohey* (03/10/2005, CACV177/2004) at §43.

[7] S.16(2)(a) of the High Court Ordinance (Cap. 4), O.18, r.17 of the Rules of the High Court (Cap. 4A) / the Rules of the District Court (Cap. 336H).

[8] *Falcon Insurance Co (HK) Ltd v Flagship Underwriting Mgmt Ltd (No. 2)* [2012] 3 HKLRD 622 at §§53,55.

[9] *Ibid,* at §53.

Electronic Co. Ltd.[10], the plaintiff claimed against the defendant for US$194,040 for its goods sold and delivered. The defendant invoked a legal set-off and sought to set-off US$52,095, representing additional expenses the defendant incurred for airfreighting the goods (as opposed to delivery by sea) due to the plaintiff's delay. The court held that such airfreight expenses constituted a liquidated debt, and the defendant was entitled to set-off against the plaintiff's claim.[11]

(d) Set-off developed at common law

This type of set-off is a common law defence well-recognised by the courts of Hong Kong.[12] In essence, it operates as a defence of 'abatement', allowing a defendant who is sued for full contract price to argue that he should not pay the full amount because the goods or services supplied by the plaintiff were defective. Rather than operating as a procedural cross-claim for damages, it directly reduces, and in effect set-off, the sum claimed against the defendant to reflect the actual diminution in value of the goods or services provided.

(e) Equitable set-off

Unlike legal set-off, which is a procedural defence, equitable set-off operates as a substantive defence.[13] It allows a defendant to reduce or extinguish a plaintiff's claim by deducting his own cross-claim against the plaintiff. An equitable set-off can be asserted even if the defendant's cross-claim is unliquidated (such as a claim for unspecified damages for breach of contract).

To successfully establish an equitable set-off, two requirements must be satisfied: (i) the defendant's cross-claim must be so closely connected to the same transaction as the plaintiff's claim; and (ii) it would be unfair to allow the plaintiff to enforce his claim without accounting for the defendant's cross-claim.[14]

For instance, in *Ng Yin Nei v Lee Chick Choi*[15], a landlord sued her tenant for arrears of rent. The tenant raised a defence of equitable set-off because the landlord failed to repair the premises, rendering them unfit for their intended purpose. The court allowed the defendant's equitable set-off against the rent, holding that it was manifestly unjust to allow the plaintiff to recover the rent without taking into account the damages the defendant suffered due to the plaintiff's failure to repair the defects in the subject premises.[16]

Jack Hon

10 Unreported, 08/09/2000, HCA 3584/2000.
11 *Ibid*, at §21.
12 Karpex (HK) Ltd at §10.
13 A procedural defence (e.g. legal set-off) allows the defendant to bring an independent claim against the plaintiff into the same court action whereas a substantive defence (e.g. equitable set-off) directly contests the plaintiff's right to claim the underlying debt.
14 *Bestway Inflatables & Material Corporation v Greyland Trading Ltd* (26/11/2003, CACV 104/2003) at §8.
15 (unreported, 05/12/2012, DCCJ 563/2010).
16 *Ibid*, at §8.

Contractual Obligations vs Statutory Obligations

Introduction

Commercial relationships are commonly governed by contracts, through which parties voluntarily assume rights and obligations. Yet contractual freedom also operates within a broader legal framework: in many circumstances, statutes may impose duties, confer rights, restrict contractual terms, or provide remedies irrespective of the parties' consent. This article examines the distinction between contractual and statutory obligations in the Hong Kong commercial law context, and the role of statutory intervention in supplementing, limiting or overriding contractual arrangements.

Sources of obligation

Contractual obligations arise from mutual agreement. As Treitel explains, a contract is "an agreement giving rise to obligations which are enforced or recognised by law" and " The factor which distinguishes contractual from other legal obligations is that they are based on the agreement of the contracting parties".[17] This consensual foundation is reflected in the requirements for contractual formation, including identifiable parties, agreement on sufficiently certain terms, and an intention to create legal relations.[18] This agreement-based model is closely connected with freedom of contract: parties are free to decide whether to contract, with whom to contract, and on what terms.

Statutory obligations, by contrast, are imposed by legislation. Their application depends on the scope and wording of the statute, not on a negotiated bargain.

17 E Peel, Treitel: The Law of Contract (14th Edn, 2015), at §1-001.
18 Halsbury's Laws of Hong Kong ("Halsbury"), at §115.003.

A person may become subject to statutory obligations because he engages in a regulated activity[19], supplies goods or services[20], acts in a particular capacity[21], or falls within a statutory category to which the legislation attaches legal consequences[22]. Such obligations may thus apply independently of consent.

Privity and scope of statutory obligations

A further distinction concerns the persons between whom obligations operate. Under privity of contract, a contract generally cannot confer rights or impose obligations on persons who are not parties to it.[23] However, statutory obligations are not confined by privity – their reach depends on the language, scope and purpose of the relevant legislation. The contractual allocation of rights and obligations is therefore not conclusive. A statute may impose duties or confer protections on persons other than those identified by the contract. Privity may limit contractual claims, but it does not limit the legislature's ability to regulate the wider transaction.

Remedies for breach

The distinction also affects the consequences of breach. In the contractual context, the parties may, subject to legal controls, specify remedies for breach. Otherwise, the law supplies default remedies[24], namely, damages. In the classic formulation in *Robinson v Harman*, contractual damages were described as aiming, so far as money can do it, to place the innocent party in the position it would have occupied had the contract been performed.[25] Contractual damages, however, are subject to limits such as mitigation and remoteness.[26] Other remedies may also be available, such as an action for an agreed sum, specific performance or an injunction.[27] These remedies are primarily directed at enforcing or compensating for the parties' bargain.

By contrast, breach of a statutory obligation may attract a wider range of consequences specified by legislation, including civil liability, criminal offences, regulatory enforcement, disqualification, or suspension or revocation of licences. The statute may also determine who can enforce the obligation and whether a private right of action exists.[28]

Statutory intervention in commercial contracts

In the commercial context, statutes may affect the parties' bargain by altering its content, enforceability or consequences. This can be seen from several examples in Hong Kong legislation.

Statutes may imply terms into contracts and control attempts to exclude them. For instance, specific buyer protection terms are implied into contracts for the sale of goods by the Sale of Goods Ordinance (Cap. 26) and the Control of Exemption Clauses Ordinance (Cap. 71). Cap. 26, requiring that the seller has the title to and right to sell the goods, that the goods are free from undisclosed encumbrances, that goods sold in the course of business are of merchantable quality and reasonably fit for any purpose made known to the seller by the buyer, and that goods correspond with their description or sample.[29] These terms do not depend on any negotiation by the parties. They operate as statutory additions to the contract, ensuring that the contract contains standards of title, quality and fitness even where the express terms are silent. Cap. 71 reinforces this protection by regulating attempts to exclude or restrict liability for breach of those implied terms: liability for breach of the implied undertaking on title cannot be excluded or restricted, whereas liability for breach of obligations as to fitness and merchantable quality cannot be excluded in consumer sales, and may only be excluded in non-consumer sales if the reasonableness requirement is satisfied.[30] Together, these Ordinances show how statutory obligations may supplement the contract and limit freedom of contract for the public good to protect consumers.

[19] E.g., Securities and Futures Ordinance (Cap. 571), s.114: Persons carrying on, or holding themselves out as carrying on, a business in a regulated activity must generally be licensed or registered, unless an exemption applies.

[20] E.g. Trade Descriptions Ordinance (Cap. 362), ss.7, 13E–13I: Traders supplying goods or services to consumers are prohibited from applying false trade descriptions to goods and from engaging in specified unfair trade practices.

[21] E.g. Companies Ordinance (Cap. 622), s.465: Company directors are subject to a statutory duty to exercise reasonable care, skill and diligence.

[22] E.g. Competition Ordinance (Cap. 619), ss.6, 21: Undertakings are subject to statutory prohibitions against making or giving effect to anti-competitive agreements and abusing a substantial degree of market power.

[23] Halsbury, at §115.145.

[24] Chitty on Contracts, 36th Ed., Vol. 1 ("Chitty"), at §30-001.

[25] *Robinson v Harman* (1848) 1 Ex. 850, at 855.

[26] Chitty, at §30-002.

[27] Where the defendant's obligation is to pay a debt or other sum due under the contract, the claimant may bring an action for the agreed sum. Where the obligation is non-monetary, the claimant may seek specific performance requiring performance of the promised act, or an injunction restraining a threatened or continuing breach. See Chitty, at §31-001.

[28] See, for example, Competition Ordinance (Cap. 619) ss.93-95, 101, 172 (pecuniary penalties, restraining or prohibition orders, director disqualification orders and criminal sanction for provision of false or misleading information); Securities and Futures Ordinance (Cap. 571) ss.194, 196 (SFC disciplinary sanctions such as revoking or suspending licence of a regulated person guilty of misconduct or revoking or suspending the registration of a relevant registered institution), Companies Ordinance (Cap. 622) ss.731-738 (statutory derivative actions may be brought by members on behalf of a company).

[29] Sale of Goods Ordinance (Cap. 26) ss. 14-17.

[30] Control of Exemption Clauses Ordinance (Cap. 71), s.11

Statutes may also alter who is entitled to enforce contractual terms. The Contracts (Rights of Third Parties) Ordinance (Cap. 623) qualifies the doctrine of privity by allowing a third party to enforce a contractual term where the contract expressly so provides, or where the term purports to confer a benefit on the third party, unless a contrary intention appears. The third party needs not provide consideration and may claim remedies as if it were a contracting party.[31]

Further, statutes may attach regulatory or criminal liability to conduct occurring within a contractual transaction. The Trade Descriptions Ordinance (Cap. 362) provides an example of this. A false or misleading description of goods or services may have contractual consequences where it forms part of the parties' agreement. Cap. 362, however, goes further by regulating such conduct independently of the contract. It prohibits false trade descriptions and regulates unfair trade practices connected with the promotion, sale or supply of products to consumers, including misleading omissions, aggressive practices and wrongly accepting payment.[32] Contravention may result in criminal or regulatory sanctions, including fines and imprisonment, beyond ordinary contractual remedies. Liability may also attach to directors, officers, partners or managers, in addition to the contracting entity.[33]

The above examples show that contractual and statutory obligations do not often operate in separate compartments. Statutes may reshape the parties' rights, liabilities and remedies, and may determine the legal effect of transactions alongside, despite the parties' agreement.

Jeremie Poon

[31] Contracts (Rights of Third Parties) Ordinance (Cap. 623), ss. 4-5.

[32] Trade Descriptions Ordinance (Cap. 362), ss. 2, 7, 7A, 13E, 13F, 13I.

[33] Ibid., ss. 18, 20.

Charitable Trust

<u>Introduction</u>

Charitable trusts, also known as public purpose trusts, occupy a unique position in Hong Kong's trust law. Unlike private trusts which must have one or more ascertainable beneficiaries, charitable trusts may be established for pure purposes provided that those purposes are recognised as charitable at law.

This article gives an overview of the essential elements of a charitable trust, and the key advantages associated with charitable status, including tax benefits and the application by the courts of the *cy-près* doctrine to "save" charitable trusts.

<u>Essential requirements of a charitable trust</u>

For any trust to be valid and enforceable under Hong Kong law, the three certainties (i.e. certainty of intention, certainty of subject matter and certainty of objects) must be satisfied. Charitable trusts are no exception, but with important adaptations due to their public nature.

In <u>*Secretary for Justice v Joseph Lo Kin Ching*</u>[34], the court confirmed that the essential elements for finding a charitable trust are:

(1) **Imperative words creating a trust**. There must be certainty on the part of the donor to impose a trust. The words used must be such that on the whole they ought to be construed as imperative. A mere expression of desire or hope will not create a trust of any kind. The word "trust" however need not be used.
(2) **Certainty of an exclusive charitable intention**. It must be clear that the trustees are bound to apply the funds to charitable purposes and not to non-charitable purposes.
(3) **Certainty as to subject matter of the trust**. The trust property must be clearly identified.[35]

Furthermore, as affirmed by the Court of Appeal in <u>*Cheung Man Yu v Lau Yuen Ching*</u>[36], a trust must meet these three conditions in order to be charitable:

(1) the purposes of the trust must have charitable character, that is, they must belong to one of the acceptable categories of **charitable purposes**;
(2) the trust must exist for the **benefit of the public**; and
(3) it must be **exclusively charitable**.

<u>(1) Charitable purposes</u>

[34] [2013] HKEC 256.

[35] *Ibid*, at para 37.

[36] [2007] 4 HKC 314.

Hong Kong has no statutory definition of "charity" and relies on common law principles. The leading authority, applied by the courts in Hong Kong,[37] is the famous dictum of Lord Macnaghten in the 1891 case of *Income Tax Special Purposes Commissioners v Pemsel*.[38] In that case, Lord Macnaghten listed four heads of charitable purposes:

(1) trusts for the relief of poverty;
(2) trusts for the advancement of education;
(3) trusts for the advancement of religion; and
(4) trusts for other purposes beneficial to the community not falling under any of the preceding heads.

This list was itself based on English legislation dating back to 1601, namely the preamble to the Charitable Uses Act 1601 in England.[39] Under the fourth head ("other purposes beneficial to the community"), the common law has developed a range of recognised charitable purposes including the promotion of health, the relief of victims of a disaster, the relief of disabled persons, the protection of animals, and the preservation of the environment.[40]

(2) Public Benefit Requirement

Public benefit means that the trust must be for the benefit of the community or an appreciably important section of it.[41] To satisfy the public benefit requirement, the trust's beneficiaries must not be identified based on a personal nexus (such as family relationship or other private connection) with a particular individual or entity.[42] For instance, in *Oppenheim v Tobacco Securities Trust Co.*[43], a trust to provide education for the children of a company's employees and former employees was held to be not charitable because the personal nexus negated the public benefit of the trust.

(3) Exclusively Charitable

A charitable trust must have purely charitable purposes. It must not have non-charitable purposes unless they are ancillary to its main charitable purposes.[44]

Advantages of Charitable Status

(1) Tax Benefits

A key benefit for being qualified as a charitable trust is that the trust will be exempted from tax under s.88 of the Inland Revenue Ordinance (Cap. 112), subject to certain conditions such as the requirement that the profits from any trade or business carried on by the trust must be applied solely for charitable purposes and must not be expended substantially outside Hong Kong. Concurrently, donors who make donations to these tax-exempt charitable trusts may claim tax deductions under ss.26C and 16D of Cap. 112.

(2) Doctrine of *Cy-près*

Another benefit is the court's power to apply the doctrine of *cy-près* (a Norman French phrase meaning "as near as possible") to remould a charitable trust when the trust can no longer carry out the charitable purposes for which it was created, thereby preserving the trust and ensuring that the trust property remains dedicated to charitable purposes as near as possible to the original ones.

Generally, charitable trusts are set up for the advancement of particular charitable purposes. The trustees of a charitable trust are under a duty to make use of the trust property to advance the charitable purposes of the trust. Occasionally, a situation might arise where the stated purposes become impossible or impractical to fulfil. Under the doctrine of *cy-près*, the court may order that the trust property be applied to a charitable purpose as near as possible to the original charitable one when the following conditions are met:[45]

(1) **Impossibility or Impracticality**: the applicant must demonstrate that it has become "impossible" or "impractical" to carry out the purposes of the charitable trust. Mere inexpediency or partial impossibility is not sufficient;[46] and
(2) **General Charitable Intention**: There must have been a general charitable intent behind the trust (i.e. an intention to devote property to charity, and that intention is not confined to a particular form of charity).

In addition to the court's power to apply new purposes as near as possible to the original ones for charitable trusts under the *cy-près* doctrine, section 3(4) of the Probate and Administration Ordinance (Cap. 10) empowers the court, on the application of the Secretary for Justice, to approve a scheme for the

[37] See, for example, *Re Tsing Shan Monestery* [2003] 1 HKLRD 237 and *Cheung Man Yu v Lau Yuen Ching* [2007] 4 HKC 314.
[38] [1891] AC 531.
[39] Law Reform Commission of Hong Kong, Report on "Charities", December 2013, at para 1.29.
[40] *Ibid*, at para 1.30.
[41] *Li Kim Sang Victor v Chen Chi Hsia* [2016] 1 HKLRD 1153.
[42] Halsbury's Laws of Hong Kong [70.007].
[43] [1951] AC 297.
[44] *Re Tsing Shan Monestery* [2003] 1 HKLRD 237.
[45] Law Reform Commission of Hong Kong, Report on "Charities" (December 2013), at paras 8.3 and 8.4.
[46] Hubert Picarda QC, *The Law and Practice Relating to Charities* (4th Edition) (2010), p.445.

disposal of the gift for such charitable purposes as it thinks fit.

Fountain Hung

Toaux Container Investment Limited v The Commissioner of Inland Revenue [2024] HKCU 3500

Facts

Touax Container Investment Limited ("Taxpayer") is a Hong Kong-incorporated company formed as part of an internal reorganisation of the Touax group of companies ("Group"). Touax Container Leasing Pte Ltd ("TCL"), another Group company, was established in Singapore.

Previously, the Group's business of operational leasing of shipping containers was carried on by Gold Container Corporation ("GCC"). Following the reorganisation, this business was transferred to the Taxpayer and TCL, with the Taxpayer acting as the trading arm and TCL as the leasing arm.

In its directors' reports, the Taxpayer described its principal activities as being the sale and leasing of shipping containers. Its role involved purchasing shipping containers and leasing them to TCL, which in turn subleased them to lessees outside Hong Kong. The Taxpayer declared a Hong Kong address ("HK Address") as its registered office and principal place of business, which was consistently and repeatedly used in trading documents, such as order confirmations and invoices.

The Taxpayer was assessed to profits tax under s. 14(1) of the Inland Revenue Ordinance (Cap. 112) for the relevant years of assessment. In response, the Taxpayer contended that:

(a) it did not employ staff in Hong Kong, though it mistakenly filed an employer's return for three employees of GCC's Hong Kong branch, one of whom was Ms. Seto;

(b) Ms. Seto's employment contract with GCC's Hong Kong branch was signed by the Group's Human Resources Director based in France, and her role included managing container activities in Hong Kong, China and the Far East; and

(c) it entered into a lease agreement with TCL ("Lease Agreement"), which was negotiated and executed by Mr. Ponak on its behalf outside Hong Kong. Under the Lease Agreement, the Taxpayer derived leasing income from TCL.

Dissatisfied with the determination of the Deputy Commissioner of Inland Revenue, the Taxpayer appealed to the Board of Review ("Board"). The Board dismissed the appeal and held that (a) the Taxpayer carried on a business in Hong Kong to earn profits; and (b) in relation to the leasing income, the Taxpayer had not sufficiently proven that the Lease Agreement was not made in Hong Kong.

The Taxpayer then appealed to the Court of First Instance ("CFI").

Issues

The issues before the CFI were:

(a) whether the Board erred in concluding that the Taxpayer carried on a business in Hong Kong under s. 14 of Cap. 112; and

(b) whether the Board erred in concluding that the Taxpayer's profits arose in or were derived from Hong Kong under s. 14 of Cap. 112.

The Law

Under s. 14(1) of Cap. 112, profits tax is generally chargeable on a person carrying on a trade, profession or business in Hong Kong, in respect of profits arising in or derived from Hong Kong from such trade, profession or business.

CFI's Ruling

Location of business

The CFI upheld the Board's decision that the Taxpayer carried on a business in Hong Kong as:

(a) only a low threshold was required to satisfy the requirements of carrying on a business under s. 14 of Cap. 112;

(b) the HK Address was not merely "brass plate": it was declared by the Taxpayer to be its principal place of business and was used in the Taxpayer's dealings with suppliers and customers; and

(c) it was not for the CFI to re-weigh the evidence and come to a different conclusion, and it could not be said that the only reasonable conclusion was that no business was being carried on by the Taxpayer in Hong Kong.

Source of profits

The CFI allowed the Taxpayer's appeal on the issue of the source of profits and held that the Board's view that the Taxpayer had profit-producing operations in Hong Kong was not clearly supported as:

(a) in relation to the Taxpayer's container trading and leasing business, the Board did not identify what profit-producing operations were conducted in Hong Kong: for example, while the Board inferred that Ms. Seto's employment contract required her to deal with trading and leasing activities of the Group in Hong Kong, it was unclear what activities she actually performed in Hong Kong for the Taxpayer;

(b) as the specific activities were not identified, it was not possible to assess whether those were indeed the operations which produced the Taxpayer's profits, or were merely antecedent or incidental to such operations;

(c) the Board appeared to have focused on matters irrelevant to the question of the source of the Taxpayer's profits, such as where Ms. Seto's employment contract was signed; and

(d) the Board's conclusion that there was insufficient evidence to prove that the Lease Agreement was made outside Hong Kong was open to question – although Mr. Ponak did not expressly state that he signed the Lease Agreement outside Hong Kong, he said that he had never visited Hong Kong for business purposes or for matters relating to the Taxpayer's trade, which was supported by his passport records.

On the Board's findings, the CFI held that it was unable to conclude whether the Board's conclusion (i.e. the Taxpayer conducted profit-producing transactions in Hong Kong) was contrary to the true and only reasonable one. Accordingly, the issue was remitted to a freshly-constituted Board for a rehearing.

Concluding Remarks

This case illustrates a fundamental principle of Hong Kong tax law: the mere existence of a business presence in Hong Kong, such as a registered office, does not in itself mean that all profits derived from such business are subject to Hong Kong profits tax. The CFI distinguished between maintaining a business presence in Hong Kong and proving where the substantive profit-producing activities occur.

The remittal of this matter for a rehearing highlights the importance of a clear and sufficient evidential basis for determining the source of profits. For businesses with cross-border operations, it is crucial to maintain clear and contemporaneous records that properly document where their core commercial activities and key decisions take place.

Silvia Tang

Up Energy Development Group Ltd (in Liquidation) [2025] 3 HKLRD 775

Facts

Up Energy Development Group Ltd (the "Company") was a Bermuda-incorporated company with its principal place of business in Hong Kong. It was an investment holding company listed on the Hong Kong Stock Exchange, with its subsidiaries engaging in business operations in the Chinese Mainland.

Following its default on certain convertible notes, the Company was undisputedly insolvent. Winding-up petitions were presented against the Company first in Hong Kong and then in Bermuda. Subsequently, provisional liquidators were appointed by the Bermuda court and were recognised in Hong Kong. After the Bermuda court made an order to wind up the Company, the winding-up petition was heard in Hong Kong.

The Court of First Instance ("CFI") made a winding-up order against the Company. An opposing creditor appealed against the winding-up order to the Court of Appeal ("CA").

Legal Issue

The three threshold requirements must be satisfied before the court will exercise its power to wind up a foreign company in Hong Kong were set out in the Court of Final Appeal's case *Shandong Chenming*

Paper Holdings Limited v Arjowiggins HKK 2 Limited[47] as follows:-

(1) There must be a sufficient connection with Hong Kong, but this did not necessarily have to consist of the presence of assets within the jurisdiction;

(2) There must be a reasonable possibility that the winding-up order would benefit those applying for it (the "second threshold requirement"); and

(3) The court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

The key issue in this case was whether the second threshold requirement was satisfied for the purpose of the petition to wind up the Company in Hong Kong.

CFI Finding

CFI held that the petitioner was entitled to a winding-up order as the three threshold requirements were satisfied. On the second threshold requirement, CFI found that the petitioner demonstrated a reasonable possibility of benefit having regard to the following matters:

(1) the Company had assets in Hong Kong, including (i) cash deposits in the Company's bank account, (ii) substantial funds spent on payment of legal costs and provisional liquidators' remuneration (which would become void and liable to be returned upon the court's making of a winding up order), and (iii) three direct Hong Kong subsidiaries which had HK$6 million of receivables; and

(2) a winding-up order in Hong Kong would give liquidators more extensive powers under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (the "CWUMPO"), as opposed to the limited powers that could be granted by rendering assistance pursuant to a recognition order.

CA's Decision

CA considered that the general principles relating to the second threshold requirement were not in dispute. The second threshold requirement was "indispensable", though the test was a low one and allowed for some flexibility as to the nature or extent of the likely benefit to the petitioner needed to be shown in order to satisfy the requirement. It would be satisfied so long as the benefit was a real possibility, rather than a merely theoretical one. The second threshold requirement applied even in relation to the making of an ancillary winding-up order in Hong Kong as in the present case.

Assets in Hong Kong

CA accepted that the presence of assets of a company in Hong Kong might mean that there would be a sufficient and tangible benefit resulting from its winding up in Hong Kong. However, on the evidence, there was no *prima facie* case that the Company had assets in Hong Kong that were of value and would enure to the creditors' benefit should the company be wound up in Hong Kong, given that:

(1) the cash deposit in the bank was expected to be irrecoverable upon liquidation due to liabilities owed to the bank;

(2) payment of the legal costs and remuneration by the Company were partly derived from loans advanced by two funders. In the absence of evidence on the terms or purpose of the loans, it would be speculative to assume that the loan proceeds would necessarily belong to the Company rather than being held on trust for the funders in the event that payment of legal cost and remuneration was disapproved by the court; and

(3) two of the subsidiaries were not the Company's direct subsidiaries but held through BVI companies, while for the third subsidiary, its receivables were dwarfed by liabilities.

Full suite of the CWUMPO powers as benefit

Although the powers available to a liquidator via Hong Kong winding up order were more extensive than those that can be conferred on a foreign liquidator via a recognition order, CA emphasized that a petitioner cannot satisfy the second threshold requirement by simply saying that there were greater powers available to a liquidator if the company was wound up in Hong Kong as well. Insofar as the availability of certain statutory powers on a winding-up may be a sufficient benefit, this was on the basis that there had to be a real possibility of some discernible benefit on the facts of the case.

In the present case, the petitioner did not point to any

[47] (2022) 25 HKCFAR 98.

aspect of the Company's affairs that called for investigation, whether for the purpose of recovery of value or from the perspectives of public interest, or any specific "more extensive power" which the Bermudian liquidators would need on the facts of the case or which would benefit the petitioner. The provisional liquidators, who had been in office for several years, also did not see any specific matter that called for investigation. A general assertion of the possibility that additional assets could be identified was insufficient.

Conclusion

CA found that the second threshold requirement had not been satisfied. Accordingly, CA allowed the appeal, set aside the Hong Kong winding-up order and dismissed the petition.

Ida Chan

Nuoxi Capital Ltd v Peking University Founder Group Co Ltd (2025) 28 HKCFAR 172

Facts

Peking University Founder Group Company Limited ("PUFG") was a Mainland holding company of a corporate group ("Group"). In 2017 and 2018, two offshore companies within the Group, Nuoxi Capital Limited ("Nuoxi") and Kunzhi Limited ("Kunzhi") (collectively "Issuers") issued bonds, valued at US$1.7 billion, which were respectively guaranteed by Hongkong JHC Co Limited ("HKJHC") and Founder Information (Hong Kong) Limited ("FIHK") (collectively "Guarantors"). The Guarantors were also subsidiaries of PUFG.

In support of the bond issuance, PUFG entered into "Keepwell Deeds" which contained obligations to maintain the financial well-being of the Issuers and the Guarantors. The provisions obliged PUFG, for each of the Issuers and the Guarantors, *inter alia*: (i) to maintain at all times a consolidated net worth of at least US$1 ("net worth obligation"); and (ii) to provide liquidity to meet their payment obligations under the bonds ("liquidity obligation"). Furthermore, in order to meet liquidity shortages, PUFG was obligated to make a lending facility available to the Issuers. According to the Keepwell Deeds, performance of these obligations was subject to PUFG obtaining the necessary regulatory approvals.

On 19 February 2020, PUFG was ordered into re-organisation in Beijing. On 16 April 2020, the bond trustee ("Trustee") declared an event of default after Kunzhi failed to make an interest payment, which triggered cross-defaults over all bonds and accelerated the payment of principal and interest.

The Issuers and the Guarantors sued PUFG for damages for breaches of the Keepwell Deeds. The claim for a monetary judgment was later abandoned in favour of a claim for declaratory relief, upon which the Issuers and the Guarantors could rely in support of proofs of debt in PUFG's re-organisation.

The Court of First Instance ("CFI")'s decision

The CFI dismissed the claims of Nuoxi, Kunzhi and HKJHC (collectively "Respondents") on a factual finding that, after PUFG was put into re-organisation, it would not have been able to obtain the regulatory approvals to transfer the required sums to the Respondents. Only FIHK's claim was allowed on the basis that PUFG had breached the net worth obligation before it was ordered into re-organisation.

The Court of Appeal ("CA")'s decision

The CA reversed the CFI's factual finding on PUFG's inability to obtain regulatory approval and allowed the Respondents' appeal. The CA rejected PUFG's argument that a failure to provide liquidity by way of a loan under the liquidity obligation did not cause any loss. The CA made declarations that PUFG had breached the Keepwell Deeds and was liable to pay to the Respondents the sums of the pre-existing debt the Respondents could have discharged had liquidity been made available to them by PUFG.

PUFG appealed to the Court of Final Appeal ("CFA") arguing that the failure to provide liquidity for the Respondents in breach of the liquidity obligation caused no actionable loss. Since the liquidity would have been provided in the form of a loan, the

Respondents would have incurred a corresponding repayment obligation, resulting in no net impact on the Respondents' balance sheets.

The CFA's decision

The CFA held that the liquidity obligation could be performed by way of a loan. Although no form or mechanism was specified in the liquidity obligation as to how sufficient funds were to be made available to the Respondents, the Keepwell Deeds required PUFG to satisfy its liquidity obligation with a lending facility in the event of default, which showed that lending was a permissible means for PUFG to perform the liquidity obligation.

On the basis that the liquidity obligation could be satisfied by a loan, the CFA held that the Respondents had suffered no net loss resulting from PUFG's breaches. The "no net loss" rule in *Stanford International Bank Ltd (in liquidation) v HSBC Bank Plc*[48] provides that any losses and gains arising from the breach must be netted off against each other, and only the net loss would be awarded as damages. Damages for breach of contract are compensatory and based on putting the plaintiff, as best as a money sum can, in the position in which it would have been had the contract been performed. Despite the failure of PUFG to advance a loan in accordance with the liquidity obligation, the Respondents did not suffer any actionable loss because, had a loan been provided by PUFG to the Respondents, the pre-existing indebtedness to the bondholders would simply have been replaced by an equal debt to PUFG.

The lack of liquidity or a state of insolvency did not alone involve financial loss. Although loss may flow from the insolvency of an entity or its winding-up, no such loss was pleaded in the Respondents' case. The CFA considered that the actual losses rested with the bondholders. The proper parties to sue for the losses were the bondholders or the Trustee because the bondholders, rather than the Respondents, suffered the loss.

The CFA also rejected the Respondents' argument that they could sue for the losses suffered by the bondholders under the doctrine of "transferred loss". The Respondents contended that application of this doctrine was necessary to prevent the bondholders' losses from falling into a "legal black hole" where they would be unrecoverable. The CFA rejected this claim, as there was no contractual intention for the Respondents to enforce the rights of the third-party bondholders. There was clearly no "legal black hole" and no injustice in leaving the bondholders and the Trustee to look after their own interests.

The CFA unanimously allowed the appeal and held that the CA's declarations should be varied to specify that the Respondents suffered no loss from PUFG's breaches of the liquidity obligation and PUFG was only liable to pay nominal damages to the Respondents.

Oswald Law

48 [2023] AC 761.