The Legal 500 Country Comparative Guides

Hong Kong: Employee Incentives

This country-specific Q&A provides an overview to employee incentives laws and regulations that may occur in Hong Kong.

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1. **What kinds of incentive plan are most commonly offered and to whom?**

   The kinds of incentive plans offered to employees typically differ depending on the industry and the seniority of the individual concerned. Generally speaking, employers typically offers bonuses (whether discretionary or contractual), commission and equity incentive plans.

   The most commonly offered incentive plans to employees are restricted stock and restricted stock unit plans, stock option plans, and deferred cash bonus arrangements.

2. **What kinds of share option plan can be offered?**

   As there is no specific legislation in Hong Kong that governs the operation of share option plans that are offered to employees, employers are free to offer different types of share options plans so long as the plans do not contravene any discrimination ordinance.

   It is common for share option plans to award participants a right to acquire shares in a parent company which is often incorporated in a foreign jurisdiction. In these circumstances, the governing law of these plans are often a jurisdiction other than Hong Kong.

   Share option plans may apply to all employees or are discretionary (for example, applies only to those at management level).

   The terms of employee share option plans generally vary in respect of vesting period, vesting conditions, forfeiture provisions, and post termination considerations.

3. **What kinds of share acquisition/share purchase plan can be offered?**

   The commentary in respect of share option plans (above) also applies to share acquisition/share purchase plans.

   The common types of share acquisition/share purchase plans offered include restricted stock units whereby shares are awarded subjected to a vesting schedule, usually based on the length of employment.

4. **What other forms of long-term incentives (including cash plans) can be offered?**

   Other forms of long-term incentives include deferred cash bonus, signing bonus, retirement schemes, severance packages.

5. **Are there any limits on who can participate in an incentive plan and the extent to which they can participate?**

   This will depend on the terms of the incentive plan. Some plans are “broad based” or “all employee” meaning that all employees have the opportunity to participate in an incentive plan. However, it is also possible for incentive plans to be limited to certain eligible employee based on the employer’s own selection criteria so long as the plan does not contravene any discrimination ordinances.

6. **Can awards be made subject to performance criteria, vesting schedules and forfeiture?**

   Yes, awards can be made subject to performance targets, vesting schedules and forfeiture clauses.

   Awards may be subjected to performance conditions, for example, that the company achieves a specific growth in share price or earnings.

   It is common for awards to vest according to a schedule at pre defined future dates. It is also common for awards to be subject to vesting conditions. Common conditions often include that the employee must remain employed and not have given or been given notice of termination, and has not been the subject of any disciplinary proceedings.

   Awards are usually forfeited if the employee resigns or if his employment is terminated for cause (i.e. gross misconduct or gross negligence). In addition, some plans include provisions under which awards might be “clawed back” in the event of misconduct.

7. **Can awards be made subject to post-vesting and/or post-employment holding periods. If so, how prevalent are these provisions both generally and by reference to specific sectors?**

   Awards can include terms which govern post-vesting and/or post-employment holding periods. However, this is uncommon.

8. **How prevalent malus and clawback provisions are and both generally and by reference to specific sectors?**

   It is not unusual to find clawback provisions in award agreements of employees in the financial sector. The award agreement should set out under what circumstances the employer would be entitled to clawback the award or any portion of it, and the mechanism for doing so.

9. **What are the tax and social security consequences for participants in an incentive plan?**

   1. **on grant;**
   2. **on vesting;**
   3. **on exercise;**
   4. **on the acquisition, holding and/or disposal of any underlying shares of**

securities; and
5. **in connection with any loans offered to participants (either by the company operating the incentive plan, the employer of the participant (if different) or a third party) as part of the incentive plan.**

1. on grant;
   Not usually subject to tax or social security consequences.
2. on vesting;
   Not usually subject to tax or social security consequences.
3. on exercise;
   Share option gains are usually taxed in the year when the share options are exercised. Similarly, share award gains are usually taxed in the year when participants are entitled to the legal ownership or economic benefits of the shares.
4. in connection with any loans offered to participants (either by the company operating the incentive plan, the employer of the participant (if different) or a third party) as part of the incentive plan.

Not usually subject to tax or social security consequences.

10. **What are the tax and social security consequences for companies operating an incentive plan?**

1. **on grant;**
2. **on vesting;**
3. **on exercise;**
4. **on the acquisition, holding and/or disposal of any underlying shares of securities;**
5. **in connection with any loans offered to participants (either by the company operating the incentive plan, the employer of the participant (if different) or a third party) as part of the incentive plan.**

1. on grant;
   Not usually subject to tax or social security consequences.
2. on vesting;
   Not usually subject to tax or social security consequences.
3. on exercise;
   The benefits of a share option scheme is usually taxed. The tax benefit of the share option is usually the difference between the price paid and the market price at the time of exercise.
4. on the acquisition, holding and/or disposal of any underlying shares of securities;
   For the assignment or release of share options, the tax benefit is usually the actual

amount of money that an employer receives from that assignment or release, less the costs for acquiring the option, if any.

5. in connection with any loans offered to participants (either by the company operating the incentive plan, the employer of the participant (if different) or a third party) as part of the incentive plan.

Not usually subject to tax or social security consequences.

11. **What are the reporting/notification/filing requirements applicable to an incentive plan?**

Benefits derived from share awards must be reported to the Inland Revenue Department. For employees and directors, those benefits must be reported in Part 4.1 of the Tax Return (Form BIR60). All taxable gains, including the gains connected with any former employment must be reported.

For employers, those benefits must be reported as the employee's income under item 11(k) on Form IR56B, item 12(k) on Form IR56F and item 11(k) on Form IR56G. In short, employers must report the particulars of gains of current and former employees and directors, which includes the year when the share option is granted, the names and identity card or passport numbers of the employees and directors, the number of shares granted and the name of the company concerned.

12. **Do participants in incentive plans have a right to compensation for loss of their awards when their employment terminates? Does the reason for the termination matter?**

This would depend on the terms of the plan. It is common for plans to differentiate the treatment of the awards depending on reason for termination. For instance, participants who resign or whose employment is terminated for misconduct usually forfeit all unvested shares and/or forfeit any entitlement to the award.

On the otherhand, if a participant is terminated by an employer but remains in good standing (for example, the reason for termination is redundancy), participants usually retain his or her right to any unvested shares which continue to vest in accordance with the governing plan, and in the case of share options, may be required to exercise any vested share options within a period of time from the date of termination.

13. **Do any data protection requirements apply to the operation of an incentive plan?**

Given that the operation of an incentive plan typically involves the collection, holding and processing of employee's personal data, these processes will be subject to the Personal Data (Privacy) Ordinance ("PDPO"), which is the main legislation governing personal data in Hong

Kong.

The PDPO applies to all personal data (in any form) that relates to a living individual and can be used to identify that individual, and will therefore include the employee’s name, job title, and compensation which might appear in the incentive plan. In practice, employers will usually obtain employee’s consent to the collection and processing of any personal data prior to the commencement of employment. The plan documentation could also have a “Privacy Information Collection Statement” setting out the purposes for which personal data is collected, the practices in relation to handling personal data and any third parties that might handle the personal data.

14. **Are there any corporate governance guidelines that apply to the operation of incentive plans?**

This will depend on where the issuer company is incorporated and whether it is a listed company in Hong Kong.

If the shares awarded to an employee concern shares in a publicly listed company in Hong Kong, the employer will likely be required to comply with the Listing Rules and corporate governance guidelines.

Pursuant to the requirements of the Listing Rules, the adoption of incentive plans must be approved by shareholders in a general meeting. The total number of securities which may be issued upon exercise of all options to be granted under the scheme and any other schemes must not in aggregate exceed 10% of the relevant class of securities of the listed issuer. In addition, the limit on the number of securities which may be issued upon exercise of all outstanding options granted and yet to be exercised under the scheme and any other schemes must not exceed 30% of the relevant class of securities of the listed issuer in issue from time to time.

15. **Are there any prospectus or securities law requirements that apply to the operation of incentive plans?**

If the incentive plan is implemented by a company prior to listing, the plan does not need to be approved by its shareholders post-listing. However, all the terms of the incentive plan must be clearly set out in the prospectus. The company must also disclose in the prospectus full details of all outstanding options, their potential dilution effect on the shareholdings upon listing, and the impact on the earning per share arising from the exercise of such outstanding options.

16. **Do any specialist regulatory regimes apply to incentive plans?**

Companies operating incentive plans should ensure that it is compliance with legislation including (i) regulations of the Securities Futures Commission and/or Hong Kong Monetary

Authority; (ii) listing rules, company ordinance, corporate governance and market abuse legislation (if applicable); (iii) discrimination ordinances; (iv) legislation on winding up.

17. **Are there any exchange control restrictions that affect the operation of incentive plans?**

As the law currently stands, there are no exchange controls applicable to employees participating in incentive plans.

18. **What is the formal process for granting awards under an incentive plan?**

The formal process for granting awards will depend on the place of incorporation of the issuer and whether it is listed, and the nature of the incentive plan.

For restricted stock units, a participant is usually provided with the governing plan and an award certificate setting out the number of shares granted to the participant.

In respect of share option plans, these are usually approved by shareholders before being approved by the directors. Upon approval and adoption of the plan, the company must issue an "Option Certificate" setting out the terms and conditions of the share option plan. It is common practice for companies to issue an explanation note providing more details regarding the procedures that employee have to follow in order to exercise the option.

19. **Can an overseas corporation operate an incentive plan?**

An overseas company can operate an incentive plan in Hong Kong. Where the overseas company already has its own incentive plan, it is possible to operate this in Hong Kong without any amendment required. In these circumstances, it is common for the plan to form a separate document and be governed under a foreign jurisdiction.

20. **Can an overseas employee participate in an incentive plan?**

An overseas employee could participate in a Hong Kong incentive plan but this could have local tax implications.

21. **How are share options or awards held by an internationally mobile employee taxed?**

This would largely depend on whether the internationally mobile employee is an 'employee' pursuant to the Inland Revenue Ordinance and whether his income is derived from or arises in Hong Kong.

22. **How are cash-based incentives held by an internationally mobile employee taxed?**

This would largely depend on whether the internationally mobile employee is an ‘employee’ pursuant to the Inland Revenue Ordinance and whether his income is derived from or arises in Hong Kong.

23. **What trends in incentive plan design have you observed over the last 12 months?**

There is a growing trend for incentive plans to contain wider clawback provisions to provide for clawback of the entire or portion of the award if the employee commits misconduct or joins a competitor post termination.

24. **What are the current developments and proposals for reform that will affect the operation of incentive plans over the next 12 months?**

The HKMA issued a consultation on Guidelines on a Sound Remuneration System on 6 May 2019 to ensure that remuneration systems of authorised institutions promote effective risk management. It is possible that these guidelines will prompt companies to review their remuneration policies and review remuneration packages for senior management.