



Accountants &  
business advisers

# Doing business in Hong Kong





PKF Hong Kong, formerly known as H. L. Leung & Company, was established in 1968 by Mr. Henry Leung in Hong Kong. After years of development, it has grown to become a medium-sized firm with more than 100 staff, providing comprehensive professional services which include:-

- . *Audit and Assurance*
- . *Tax and Business Advisory*
- . *Corporate Finance*
- . *Bookkeeping*
- . *Management Consultancy*
- . *Company Secretarial and Corporate Services*

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We are proud to provide business solutions in a global context.

As a member firm of PKF International Limited, we provide clients with high quality services that are tailored to meet their own specific requirements. Incidentally, the word PKF also has a mnemonic value to our philosophy of serving clients with the three main attributes of "Professionalism", "Knowledge" and "Friendliness".

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# Contents



## Foreword

## Our services for inward investors

	Page
<b>Chapter 1 – Introduction</b>	
• <i>Geography and population</i>	3
• <i>Political environment</i>	3
• <i>Economy</i>	4
• <i>Regulatory environment</i>	5
• <i>Financial services</i>	5
• <i>Exchange control</i>	5
• <i>Currency</i>	5
<b>Chapter 2 – Business structure</b>	
• <i>Limited liability company</i>	6
• <i>Branch of a foreign company</i>	8
• <i>Representative office of a foreign company</i>	8
• <i>Sole-proprietorship</i>	9
• <i>Partnership</i>	9
• <i>Joint venture</i>	9
<b>Chapter 3 – Business finance</b>	
• <i>Equity finance</i>	10
• <i>Debt financing</i>	11
• <i>Government grants</i>	12
<b>Chapter 4 – Accounting</b>	
• <i>Accounting standards</i>	14
• <i>Audit requirements</i>	14

## **Chapter 5 – Taxation**

- *Overview* 16
- *Taxation on letting property* 19
- *Tax implications on different business entities* 19
- *Tax obligations of employers* 21
- *Tax obligations of employees* 21
- *E-business* 22
- *Ceasing to have a business presence in Hong Kong* 23
- *Double taxation agreement* 25

## **Chapter 6 – Foreign personnel**

- *Entry into Hong Kong* 31
- *Salaries tax liabilities* 32
- *Mandatory provident fund scheme* 32
- *Employee's rights* 33
- *Individuals leaving Hong Kong* 34

## **Chapter 7 – Doing business in PRC through Hong Kong**

- *Overview* 35
- *Hong Kong – a unique city in PRC* 35
- *CEPA – better market access and more savings on tariffs* 36
- *Making use of Hong Kong Company as an investment* 36
- *Vehicle to invest in PRC* 37

## **Useful contacts**

40

## **PKF contacts**

43

# Foreword



The purpose of this brochure is to provide foreign investors with a general understanding of doing business in Hong Kong. It is not written as a comprehensive guide. Rather, it is designed to provide information on major issues that foreign investors should consider when investing in or through Hong Kong.

Hong Kong is a major financial and trading centre in the world and has been serving as the gateway into the Mainland China for more than a century and a half. Many foreign investors choose Hong Kong as their stepping-stone for entering China because she possesses the freest economy in the world and the talents who have good understanding of both Chinese and Western cultures.

By taking advantage of the PKF International network and with our good understanding of Chinese culture and business environment, we are able to provide comprehensive services to our clients, helping them in setting up their business and exploring opportunities in China. We look forward to co-operating with you and assisting your business to grow and achieve success in the future.

Last but not the least, we would like to express our gratitude to the InvestHK Department of the Hong Kong Government for their support in providing us with reference material in the course of our writing this brochure.

Henry Leung  
Senior Partner  
December 2008

# Our Services for Inward Investors



## Audit and Assurance

Our audit and assurance team has been operating since the beginning of our business and has been the core service of our firm. In addition to audit, our professional team provides service and advice to clients on various areas including initial public offering, mergers and acquisitions, business valuation, transaction support, financial due diligence, litigation support, system evaluation and appraisal, budgetary control and financial certification for migration, etc.

## Tax and Business Advisory

Our tax and business advisory division comprises of highly trained professionals who are committed to delivering value-added services to clients from different sectors. One of our strengths lies with our close working relationship with the clients enabling us to give concrete advice at the early stage of their development plans such that the business decisions to be made by them are both viable and tax efficient. As experienced and independent professionals, we are well equipped to provide efficient and cost-effective advice in various areas to cater for the clients' specific needs such as Hong Kong and China tax consultation, cross-border business advice, tax due diligence review, corporate restructuring, tax compliance and tax audit advice, etc.

## Company Secretarial and Corporate Services

We assist clients in setting up new companies in Hong Kong and provide corporate support services including visa applications for expatriate employees, provision of registered office, business registration, bank accounts opening, attending board meetings and preparing board minutes, company share transfer, company dissolution, trademark registration and payroll management, etc.

## Bookkeeping

We provide tailor-made bookkeeping services to clients from all business fields with various solutions to free themselves from accounting routine and supervision works. The range of services includes:

- . Designing and setting up appropriate accounting system.
- . Designing financial reports with customized format.
- . Preparing general ledgers and financial statements for management purpose.
- . Preparing annual accounts for audit purpose.
- . Operating client's bank accounts and handling receipts of funds and payments of expenses.
- . Handling invoicing, MPF statements, etc.
- . Preparing budgets and cash flows.
- . Costing implementation and analysis.
- . Preparing financial and operational analysis for management control and planning process.

## Corporate Finance

Corporate Finance is an offshoot of PKF Hong Kong office. It is complementary to other business units in providing a suite of services to clients. To an enterprise, sources of funding and financial management play a vital role in its growth and development. Here we provide services in three distinctive areas, namely, debt financing, capital market fund raising and financial management advisory to commercial entities as well as not-for-profit organizations. In 2006 June, we added to our suite logistics management advisory service in response to our clients who have the need as much as financial advisory.

## Management Consultancy

Our Management Consultancy Division provides services and advice to clients on various areas such as management and accounting systems design, system evaluation and appraisal, budgetary control, design and implementation of cost reduction programme, etc.

# Introduction



Hong Kong is situated in Southern China near Guangzhou and Macao and was a former British colony in South East Asia.

## 1.1 Geography and Population

Hong Kong consists of Hong Kong Island, Kowloon Peninsula, the New Territories, Lantau Island and more than 260 outlying islands. It is long established as the southern gateway of China and the trading hub in Asia Pacific region. Hong Kong is one of the most densely populated cities in the world with approximately 7.5 millions people living in an area of less than 404 square miles. Although above 90% of local residents in Hong Kong are ethnic Chinese, there is a substantial number of expatriates living in the city.

## 1.2 Political Environment

After 156 years of British administration, the Government of the People's Republic of China ("PRC") resumed the sovereignty of Hong Kong on 1 July, 1997 and established the Hong Kong Special Administrative Region on the same day. Thereafter Hong Kong is a special region of the PRC which enjoys high autonomy on both legal and administrative affairs.

The PRC Government assures through the enactment of the Basic Law that the socialist system shall not be practised in Hong Kong and that the way of life in the territory shall remain unchanged for 50 years (i.e. up to the year 2047). With this "One Country, Two Systems" policy, Hong Kong continues as a low tax, free port and capitalist territory.

The Basic Law further provides, inter alia, that:

- i. Hong Kong is vested with executive, legislative and independent judicial powers including that of final jurisdiction.
- ii. Hong Kong retains her status as an international financial centre. Her free market in foreign exchange, gold, securities and futures continue. There is free flow of capital within, into and out of the territory. Hong Kong dollars continue to circulate freely and remain freely convertible.
- iii. The current social and economic systems in Hong Kong remain unchanged. Private property, ownership of enterprise, legitimate right of inheritance and foreign investments are protected by law.
- iv. Hong Kong maintains the status as a free port and except a number of items, does not impose any tariff.
- v. The laws previously in force in Hong Kong are maintained.

Above all, apart from the replacement of a new national flag, there is not much change in Hong Kong. She is still one of the few governments in the world that practises free trade policy. There are no restrictions on foreign investment, no restrictions on repatriation of capital and profits—free foreign exchange, excellent telecommunications systems and simple territorial tax regime. Hong Kong also continues to adopt the well-established common law legal system, which is very familiar to that in many of the home countries of the foreign investors. Both foreign and local corporations are registered under the same rules and subject to the same sets of business regulations and taxes.

### **1.3 Economy**

Hong Kong is widely recognized as one of the major financial and trading centres in the world. The economic success of Hong Kong is mainly attributable to its adoption of a simple tax regime with low tax rates and free trade policy by the Hong Kong Government. There are no barriers to trade, no restrictions on inward or outward investments and no nationality restrictions on corporate or sectoral ownership. Hong Kong has been ranked as the world's freest economy by the studies done by various international authorities, such as the Heritage Foundation from the United States and the Cato and Fraser Institutes of Canada.

## **1.4 Regulatory Environment**

The administration of Hong Kong is headed by the Chief Executive appointed by the PRC central government. The Chief Executive appoints members of the Executive Council, which is a think tank for formulating government policies for the territory. The Legislative Council is the legislative body responsible for passing laws and controlling government expenditure. It has 60 members with 30 of them are returned by geographical constituencies through direct elections and the remaining 30 members by functional constituencies.

Although Hong Kong returned to the PRC in 1997, Hong Kong still retains her own legal system. The British common law system is still practised in the territory. The judiciary is independent of the Legislative and Executive Councils, and its judges are drawn from Commonwealth jurisdictions as well as from Hong Kong itself. Cases are heard in English and/or Chinese.

## **1.5 Financial Services**

Hong Kong is one of the major financial centres in the world. Many international financial institutions establish branches and offices here providing full range of financial services.

## **1.6 Exchange Control**

There is no exchange control in Hong Kong.

## **1.7 Currency**

The official currency in Hong Kong is the Hong Kong dollar (HK\$), which is pegged with the US dollar at HK\$7.78 per US\$1. Due to the closer economic relationship between PRC and Hong Kong, some shops in Hong Kong also accept Renminbi ("RMB"), the official currency of PRC.

# Business Structure



Foreign investors can set up virtually any type of business in Hong Kong without first obtaining government approval (except banking, insurance and shipping business). However, every person commencing business in Hong Kong must register with the Business Registration Office within one month from the date of business commencement. A valid business registration certificate will be issued by the Business Registration Office and it must be displayed to the public at every place of business. Such certificate is renewed annually.

## 2.1 Limited Liability Company

The procedures for setting up a limited liability company in Hong Kong are relatively simple:

- i. Before a company is incorporated, its name must be filed first and approved by the Companies Registry. The registrar will reject a proposed name if it is identical to or will cause confusion with another company name already registered. Then the foreign investor can proceed with the registration procedures. A lot of professional firms in Hong Kong, including our associate, Hongkong Managers & Secretaries Limited, provide such services to clients.
- ii. There is a statutory minimum requirement of one shareholder and one director for setting up a limited liability company. Anyone (corporation or natural person) can be a shareholder and director of a Hong Kong company. There is no restriction on foreigners acquiring shares in Hong Kong companies. Shares can be registered in name of persons residing outside Hong Kong. Beneficial owners may also appoint nominee shareholders to hold shares for them if they wish to keep their identity confidential.
- iii. Hong Kong company is required to have a statutory secretary. It also must have an address in the territory and the statutory secretary has to be a Hong Kong

resident if it is an individual. Where a corporation acts as the statutory secretary, it must have its registered office or place of business in Hong Kong.

- iv. There is no requirement as to the minimum amount of share capital. As such, many Hong Kong companies are established with a paid-up share capital of HK\$1 only. It is advisable for authorized capital to be kept as low as possible in order to reduce the capital duty (i.e. 0.1% on the par value of issued shares). But it is sometimes necessary for a Hong Kong company to have a large share capital in order to fulfil the asset backing requirement of bankers, business partners or customers, etc.
- v. When every thing is in order, it takes around two weeks to incorporate a limited liability company. However, there are also some “ready-made” companies in the market, which are available for immediate use.
- vi. When the company is duly registered with the Companies Registry, the registration with the Business Registration Office is much simpler. Either the director or the company secretary can represent the company to apply for the business registration certificate.
- vii. Hong Kong company has to hold an Annual General Meeting of shareholders and at least one Board of Directors’ Meeting every year. Directors’ meeting can be held anywhere. Shareholders’ meeting can also be held outside Hong Kong provided that there is nothing to prevent this in the Articles of Association. The minutes of meetings are often prepared by a professional firm acting as the statutory secretary.
- viii. Every year, a Hong Kong company must complete an Annual Return and file with the Companies Registry where is open for public inspection. The Annual Return gives details, among others, of a company’s share capital, members and directors.
- ix. Hong Kong company has to keep proper books of accounts. The accounts have to be audited by an auditor holding a practicing certificate issued by the Hong Kong Institute of Certified Public Accountants. The company is not required to file audited accounts with the Companies Registry. Therefore, the company’s financial position is not available to the public. But the annual audited accounts have to be submitted to the Hong Kong Inland Revenue Department together with the annual Corporation Profits Tax Return for assessment.

## 2.2 Branch of a Foreign Company

A foreign corporation may establish a branch in Hong Kong by applying to the Companies Registry for approval within one month of business commencement and providing the following documents:

- i. A certified copy of the Memorandum and Articles of Association of the corporation head office or other instruments defining its constitution. If the instrument is not written in Chinese or English, a certified translation of the document is required.
- ii. A list of the names, nationalities and residential address of the directors and shareholders of the company.
- iii. The name and address of at least one person resident in Hong Kong who is authorized to accept legal notice served on the company.
- iv. Name and address of the company's statutory secretary.
- v. The address of the principal place of business of the Hong Kong branch.
- vi. The address of the principal place of business and registered office of the foreign company in its place of incorporation.
- vii. A memorandum of appointment or power of attorney authorizing a person to accept legal notice for the company in Hong Kong.
- viii. A certified copy of the company's certificate of incorporation and a certified translation of the certificate if it is written in a language other than Chinese and English.

## 2.3 Representative Office of a Foreign Company

A foreign corporation may also consider setting up a representative office in Hong Kong. Firstly, it has to obtain a business registration certificate from the Business Registration Office. Then the representative office is required to register under the Companies Ordinance unless:

- i. The representative office does not conclude contracts in Hong Kong other than contracts for employing domestic staff, purchasing furniture and fixture, etc.;

- ii. The representative office does not maintain accounts in Hong Kong; and
- iii. The representative office receives no income in Hong Kong.

If the representative office only acts as a liaison or buying office of its overseas head office and does not conclude any sales contract in Hong Kong, it is not subject to Hong Kong profits tax.

## **2.4 Sole-Proprietorship**

It is simple to set up a sole proprietorship business in Hong Kong. The only formality is to obtain a business registration certificate from the Business Registration Office.

## **2.5 Partnership**

Similar to the sole proprietorship business, the only formality for the establishment of a partnership is to obtain a business registration certificate. Copies of the Hong Kong Identity Cards and/or passports of all partners have to be attached to the business registration application form. Furthermore, there must be an office address in Hong Kong and at least one of the partners must reside in the territory. If all partners are stationed overseas, there must be a manager who resides in Hong Kong to represent the partnership. The Partnership Ordinance governs the operations of partnership business in the territory.

## **2.6 Joint Venture**

There are no specific legislations in Hong Kong governing the operations of joint venture. Usually, joint ventures are treated as partnerships and are so assessed by the Inland Revenue Department.

# Business Finance



Since Hong Kong is one of the major financial centres in the world, there are many alternatives that are available to an investor for financing its business operations.

## 3.1 Equity Finance

### 3.1.1 Venture Capital

Venture capital, also known as “direct investment” or “private equity”, is a means of providing long-term equity to young and fast growing companies. Venture capitalists inject funds into a targeted company in exchange for a proportion of its equity. They are prepared to assume higher risk by investing at the early stage of a company’s development in return for a higher return resulting from the company’s future success.

Due to the lack of a strong track record, start-up companies are usually difficult to obtain funds from banks and financial institutions to finance the expansion of their business. Venture capitalists can assist these companies in this regard by injecting capital into them. They usually require board representation and will take an active interest in the investee companies’ affairs. Apart from the provision of equity fund, some professional venture capitalists will also provide advice on business strategy, management, organization and financial system, etc. for assisting the companies’ growth.

Hong Kong Venture Capital Association (<http://www.hkvca.com.hk>) was established in 1987 with the objective of promoting and protecting the interests of the venture capital industry in the territory. Hong Kong is the second largest venture capital centre in Asia. There were 203 Hong Kong-based funds with capital under management amounting to US\$51 billion as of June 2007.

### 3.1.2 Listing

Public listing is an effective means for raising capital and expanding business. Besides access to capital for growth, listing also offers various benefits to a company, including

broadening of shareholder base, improving corporate transparency, gaining higher publicity and providing motivation to employees through share option schemes, etc.

Hong Kong stock market is ranked amongst the top 10 in the world in terms of market capitalization. With the rapid growth of the PRC economy and the strong funding needs of the Chinese enterprises, the Hong Kong stock market is expected to grow drastically in the near future.

Depending on the operating history and financial status, companies may either choose to list its shares on the Main Board or in the Growth Enterprise Market (“GEM”). GEM was established in 1999 with the objective of providing a more favourable marketplace for new and high growth companies to raise funds for business development. Companies seeking to list on the Main Board will be subject to stricter requirements including three-year solid track record of trading and income earnings. Hong Kong Exchanges and Clearing Limited is the company responsible for governing the operation of the Hong Kong stock market.

## **3.2 Debt Financing**

There are various banks and financial institutions operating in Hong Kong providing full range of financial services to companies. These include:

### **3.2.1 Overdraft and Revolving Credit Facilities**

An overdraft facility is usually used for financing short-term needs such as payment of salary, utility bills, rentals, and other routine overhead expenses. Interest is only charged on the utilized debit balance, which is reduced at any time at the borrower’s discretion through cash deposits.

### **3.2.2 Term Loans**

Term loan is a loan that has a fixed repayment period and either fixed or floating interest rate. It is more suitable for financing medium to long terms needs, as the borrower can budget his future cash flows according to his needs. When applying for a term loan, the bank usually requests the company (the applicant) to provide its property or asset as collateral. In addition, it may also request personal guarantee from the directors or shareholders.

### **3.2.3 Hire Purchase and Leasing**

Instead of purchasing machinery or asset in cash, it is very common for a company to purchase asset through hire purchase or leasing arrangement. Alternatively, the company can enter into a “sales and lease-back” arrangement with the bank whereby the company sells its existing equipment to the bank and leases it back. Both arrangements can ease the burden on the company’s cash flows by matching lease payments against the revenue generated from the equipment.

### 3.2.4 Invoice Factoring

Invoice factoring, also known as accounts receivable factoring, is a financing service that allows a company to sell the account receivables to a bank or a financial institution for immediate funding. The bank or financial institution usually buys the receivables from the company at a discount and then collects the full amount when the receivable is due. The difference is treated as the finance charge payable or factoring fee for the financing arrangement. It enhances a company’s cash flows by utilizing funds that are normally tied up in receivables.

## 3.3 Government Grants

To support the small and medium enterprises (“SMEs”), Hong Kong Government has set aside HK\$1.9 billion to establish the following funding schemes with a total commitment of HK\$7.5 billion to help SMEs coping with new challenges and opportunities:

### 3.3.1 SME Loan Guarantee Scheme (SGS)

The SGS aims to help SMEs secure loans from participating lending institutions for:

- *Acquiring business installations and equipment;*
- *Meeting additional operational expenses arising from or in relation to the business installations and equipment acquired or to be acquired under the SGS; and*
- *Meeting their working capital needs arising from provision of credit terms to their customers.*

The overall objective is to assist SMEs to enhance productivity and competitiveness.

### 3.3.2 SME Development Fund (SDF)

The SDF aims at providing financial support to projects carried out by

non-profit-distributing organizations operating as support organizations, trade and industrial organizations, professional bodies or research institutes to enhance the competitiveness of Hong Kong's SMEs in general or SMEs in specific sectors. Applicants shall either be a statutory organization or a registered organization under the laws of Hong Kong. Projects in receipt of other public funding sources will not be funded.

### 3.3.3 SME Export Marketing Fund (EMF)

The EMF aims at helping SMEs expand their business through participation in export promotion activities. The EMF provides grants to SMEs for their participation in overseas trade fairs or exhibitions and study missions, as well as local trade fairs or exhibitions, which are export-oriented. Such export promotion activities must be organized by experienced and reputable organizations or companies and directly relevant to the business of the applicants. The form of SMEs' participation must be exhibitors of the trade fairs or exhibitions or as delegation members of the study missions.

For details of the above funding schemes, please visit: <http://www.smefund.tid.gov.hk>.

### 3.3.4 Other Funding Schemes

Besides the funding schemes mentioned above, other government departments and supporting organizations also offer a variety of supporting schemes to local SMEs. These include:

- *Innovation & Technology Fund*
- *Design-Business Collaboration Scheme*
- *Patent Application Grant*
- *New Technology Training Scheme*
- *Business Start-up Centre*
- *Incu-Tech Programme*
- *Film Guarantee Fund*
- *Professional Services Development Assistance Scheme*
- *OSH Enhancement Scheme for SMEs*

For details of the above funding schemes, please visit:

[http://www.sme.gcn.gov.hk/smeop/english/otherfunding\\_e.cfm](http://www.sme.gcn.gov.hk/smeop/english/otherfunding_e.cfm)

# Accounting



## 4.1 Accounting Standards

The Hong Kong Institute of Certified Public Accountants (“HKICPA”), formerly known as the Hong Kong Society of Accountants, is Hong Kong’s only statutory licensing body of accountants. It is responsible for the training, development and regulation of the accounting profession in Hong Kong. It has a membership of over 22,000 accountants and about 11,000 registered students.

The HKICPA has completed in 2004 its convergence of the Hong Kong Financial Reporting Standards (“HKFRS”) with the International Financial Reporting Standards (“IFRS”) promulgated by the International Accounting Standards Board. It follows that effective for accounting periods beginning on or after 1 January, 2005, all company accounts in Hong Kong that are prepared in accordance with the Hong Kong Accounting Standards will comply with the relevant IFRS at the same time. In summary, the HKFRS comprise of the Hong Kong Financial Reporting Standards, the Hong Kong Accounting Standards and their Interpretations issued by the HKICPA

## 4.2 Audit Requirements

All limited liability companies in Hong Kong are required to appoint qualified and independent auditors to perform annual statutory audit on their accounts except for licensed branches of foreign banks.

For a newly incorporated company, the directors may appoint their first auditor at any time before the first annual general meeting held not later than 18 months from its incorporation date. The auditor being appointed by the company must be a Certificated Public Accountant qualified under the Professional Accountants Ordinance and must hold a Practicing Certificate issued by the HKICPA.

The auditors are required to report to the members of a company on the accounts

audited by them and on every balance sheet, profit and loss accounts, and all group accounts laid before the company in the Annual General Meeting during the time they hold the office of auditors. The auditors are also required to report whether or not the financial statements show a true and fair view, and comply with the Companies Ordinance and other laws applicable to certain regulated industries. They are responsible for ensuring that the financial statements contain all information required to be disclosed by the Companies Ordinance.

Although the Companies Ordinance requires auditors to express an opinion on the truth and fairness of financial statements, it does not give any guidance or procedures on how the auditors should proceed in reaching the opinion. In practice, auditors are required to carry out their audits in accordance with the auditing standards and statements promulgated by the HKICPA. These standards and statements prescribe the basic principles and practices which auditors are expected to follow. In addition, there are a number of auditing guidelines on procedures by which the auditing standards, the application of the auditing standards to specific items appearing in the financial statements, and techniques currently being used in auditing may be applied. They also give guidance as to resolving audit problems, which relate to particular commercial or legal circumstances or specific industries.

# Taxation



## 5.1 Overview

Hong Kong is well known as one of the lowest tax regimes in the world. Hong Kong adopts a territorial tax system under which only Hong Kong source income is tax chargeable. Therefore, it is very important to identify the source of income before determining the liabilities of a taxpayer in Hong Kong.

In Hong Kong, the “year of assessment” is a 12-month period commencing from 1 April of any year and ending on 31 March in the following year. If a company’s 12-month accounts end on a date other than 31 March, its accounts year-end date will determine the year of assessment in which the company’s accounts in question should fall. For instance, year of assessment 2008/09 is the basis period for an accounting year-end date of 31 July, 2008 because the closing date (i.e. 31 July, 2008) falls within the period between 1 April, 2008 and 31 March, 2009.

### 5.1.1 Salaries Tax

Salaries Tax is charged on an individual in respect of his/her income arising in or derived from any office, employment or pension in Hong Kong. The amount of tax payable is calculated at the lower of:

- i. The standard rate on chargeable income after deduction of charitable donations; or
- ii. The applicable progressive rates on net chargeable income after the deduction of charitable donations and personal allowances.

### 5.1.2 Personal Assessment

Hong Kong's tax system does not tax an individual on his/her total income. Rather, sources of income are taxed under separate categories (i.e. business income is subject to profits tax, rental income is subject to property tax and employment income is subject to salaries tax).

Sometimes, it may be advantageous for an individual to elect to pay tax under "personal assessment" if he/she has expenses which may not be deductible against a particular source of income (e.g. mortgage interest payments) or allowable tax losses which cannot be completely absorbed by his/her business profits. Under personal assessment, all his/her assessable sources of income are aggregated in a single assessment.

Applicants must be permanent or temporary residents in Hong Kong. An election for personal assessment must be made within a stipulated time limit.

### 5.1.3 Profits Tax

Every individual, corporation, partnership or unincorporated business venture carrying on a trade, profession or business in Hong Kong is subject to tax on profits which are generated from sources within the territory.

For profit to be taxable in Hong Kong, the following are the qualifying conditions:

- i. The person must be carrying on a trade, profession or business in Hong Kong;
- ii. The income must arise in or be derived from Hong Kong from such trade, profession or business; and
- iii. The receipt must be revenue (not capital) in nature.

In computing the assessable profit, a company is entitled to deduct business expenses that were incurred in generating its taxable income. Deductions on capital expenditure are however prohibited (unless it is provided in the Inland Revenue Ordinance).

The Hong Kong Inland Revenue Department ("IRD") grants a system of allowance on certain qualifying capital expenditures for the purpose of a trade, profession or business in Hong Kong, including assets falling within the definition of plant and machinery,

industrial buildings and commercial buildings.

- i. Plant and machinery allowances comprise an initial allowance of 60% on the acquisition cost and annual allowance of 10%, 20% or 30% on the estimated working life of the particular category of plant or machinery. Items qualifying for the same rate of annual allowance are grouped in one pool.
- ii. Industrial building allowance of 20% on construction costs of building incurred in certain trades such as transport, manufacturing, processing or storage of goods is granted. An additional allowance of 4% on the expenditure is also granted annually until the total construction cost is written off.
- iii. Commercial building allowances are granted for expenditure on construction of a building other than industrial building at the rate of 4% per annum against cost.
- iv. Capital expenditure incurred on certain prescribed fixed assets in any year of assessment is allowed to be fully written-off. "Prescribed fixed assets" include computer hardware and software, and certain defined plant and machinery that are used specifically and directly for any manufacturing process.
- v. Capital expenditure on refurbishment of a building or structure (other than a domestic building or structure) can be amortized at 20% per annum.
- vi. Accelerated deduction for capital expenditure on specified environmental protection facilities with effect from 2008/09. For machinery or plant, 100% full deduction will be allowed for the expenditure incurred. For installation forming part of a building or structure, 20% deduction will be allowed for each year in five consecutive years.

#### **5.1.4 Capital Gain Tax**

There is no capital gain tax in Hong Kong.

#### **5.1.5 Value-added Tax and Customs Duty**

There is no value-added tax in Hong Kong. However, the Hong Kong Government is considering the introduction of Goods and Service Tax in order to broaden the tax base of the territory.

Hong Kong is well known as a duty-free port. It means that imported goods are not taxed in Hong Kong with the exception of only a few items such as tobacco, alcohol and some petroleum products.

### 5.1.6 Stamp Duty

Stamp duty applies only to the following categories of transactions:

- i. Contract notes on the transfer of Hong Kong shares and marketable securities;
- ii. Assignments of immovable property;
- iii. Leases and assignments of leases of Hong Kong property; and
- iv. Issuance of bearer instrument.

Transactions in Hong Kong shares or marketable securities are subject to an ad valorem duty of HK\$2 per HK\$1,000 value payable equally by both the buyer and seller. Stamp duty on transfer of immovable property is levied at progressive rates in accordance with the sales consideration.

## 5.2 Taxation on Letting Property

Property tax is charged at a standard rate on the net assessable value of any land or building in Hong Kong. The net assessable value is the assessable value (i.e. rental income after deduction of rates paid by the owner and irrecoverable rent) less a notional allowance of 20% for repairs and maintenance.

## 5.3 Tax Implications on Different Business Entities

Foreign investors intending to establish business presence in Hong Kong can either choose to set up a liaison office, a branch or a Hong Kong limited liability company.

There is basically no difference in profits tax liabilities on inbound investment made through a branch or a Hong Kong incorporated company. They are subject to the same sets of business regulations and taxes. The main cost saving from operating as a branch, as opposed to a Hong Kong incorporated company, is that the capital duty of 0.1% on authorized share capital is not required.

From commercial and legal perspectives, a Hong Kong incorporated company may have certain advantages over a branch. Since it is a separate legal entity, its shareholders enjoy limited liability. Another advantage of operating through a Hong Kong incorporated company is that reorganization of group activities and tax planning is often easier.

### 5.3.1 Liaison Office

Strictly speaking, a liaison office is different from a branch office. Liaison office does not conduct trade nor enter into business contract with other entities by itself. Rather, it only acts as a cost centre engaged in ancillary activities such as coordinating buying activities in the region, communicating with customers on behalf of the head office, doing market research, etc. If the liaison office does not directly involve in any trading activity nor possess the general authority to enter into purchase and sales contracts with suppliers and customers, it is not regarded as carrying on business in Hong Kong and therefore not subject to Hong Kong profits tax.

### 5.3.2 Branch or Limited Liability Company

A branch can directly involve in trading activity and enter into business contracts on behalf of its overseas head office. In Hong Kong, there is no distinction between branch profits tax and corporation profits tax. Both of them are subject to the same tax rate.

- i. Taxation on a branch or Hong Kong incorporated company: Since Hong Kong adopts the territorial tax regime, no distinction is made between a resident and non-resident. Profits Tax liability of a company is determined by reference to the source of income (i.e. the place where the income is actually derived from), not residency. Same set of tax regulations are applied to both public limited companies and private limited companies. Taxable profits are calculated, based on the accounting profits shown on the audited financial statements with tax adjustments on some specific items.
- ii. Tax loss: Losses incurred can be carried forward indefinitely to set off against future assessable profits of the same entity. However, there are anti-avoidance provisions in the Inland Revenue Ordinance restricting the use of tax losses where a change in shareholding was undertaken solely or dominantly for the purpose of utilizing the losses to obtain a tax benefit. Losses cannot be carried backwards.

- iii. Transfer pricing and associated entitles: Inter-company service fee (e.g. management fee, training fee, administration fee, etc.) within a group is tax deductible if it is incurred for generating the company's taxable profits and the amount involved is reasonable (i.e. on an arm's length basis). If a Hong Kong resident company carries on business with a closely-connected non-resident company and the business is arranged in such a way that the Hong Kong resident company produces no profits or less than the ordinary profits that could be expected to be sourced in Hong Kong, the business of the non-resident company is deemed to be carried out in Hong Kong. The non-resident company's profits will be tax chargeable in name of the Hong Kong resident company.
- iv. Group tax loss relief: Companies of the same group are assessed to profits tax separately. There is no group tax loss relief in Hong Kong.

## 5.4 Tax Obligations of Employers

All employers in Hong Kong are required to file the Employer's Return of Remuneration and Pensions to IRD within one month from the date of issue of the Return (i.e. usually, the first working day of April) reporting details of the remuneration paid to their employees (including directors) during the year ending 31 March.

Employers are also required by law to notify IRD by completing the appropriate forms in the following situations:

<u>Employment Status of Employee</u>	<u>Time Limit for Filing</u>	<u>Form No.</u>
i. Commencement of employment	Within 3 months from the date of commencement of employment	IR56E
ii. Continuous employment to 31st March	Within 1 month from the issue date of the Employer's Return	BIR 56A & IR 56B
iii. Cessation of employment	At least 1 month before the date of cessation of employment	IR 56F
iv. Cessation of employment & leaving Hong Kong *	At least 1 month before the expected date of departure from Hong Kong	IR 56G

\* Employers have to withhold ALL monies payable to the employees within one month from the date of filing the Form IR 56G. Upon settlement of salaries tax by the employees, IRD will issue a written consent to the employers (the "Letter of Release") to release the monies withheld.

## 5.5 Tax Obligations of Employees

Hong Kong employers are not required by law to withhold salaries tax for their employees. It is the employees who have the statutory obligations to report to IRD and pay the required tax.

An employee is required to notify IRD in writing the following matters in connection with his/her employment in Hong Kong:

<u>Employment Status</u>	<u>Time Limit for Reporting</u>
i. Commencement of employment	Within 4 months after the end of the basis period for that year of assessment.
ii. Continuous employment to 31 March	Within 1 month from the date of issue of Individual Tax Return by IRD.
iii. Cessation of employment	At least 1 month before the date of cessation of employment.
iv. Leaving Hong Kong for more than 1 month (other than business trip)	At least 1 month before the expected date of departure from Hong Kong.

In general, IRD issues Tax Returns to all individual taxpayers on the first working day of May each year requiring them to report their taxable income for the year ending 31 March. After reviewing the submitted Returns, IRD will issue Notice of Salaries Tax Assessment to taxpayers for payments.

IRD usually issues the Notice of Salaries Tax Assessment to taxpayers in October each year. The assessment notice not only demands Salaries Tax payment on last year employment income, but also demands for advance payment of the following year's Salaries Tax (i.e. provisional tax), which is calculated by reference to last year employment income. Two payment instalments are usually provided by IRD. The due date of the first payment is normally in January of the following year, at which time, all outstanding final tax plus 75% of the provisional tax are payable. The remaining 25% of provisional tax will usually be due for payment in April of the following year.

## 5.6 E-business

The IRO does not contain any provision that specifically deals with the taxation of e-commerce. It is the tax policy of IRD to adopt the principle of neutrality of treatment on e-commerce business. Same tax principles therefore are applied to both e-commerce and conventional forms of business.

When determining whether profits derived from an e-commerce business is subject to profits tax in Hong Kong, it is important to determine:

- i. Whether or not the business is considered carried on in Hong Kong; and
- ii. Whether or not the profits are Hong Kong sourced.

In determining whether or not a person is carrying out business in Hong Kong, IRD will take into consideration the totality of facts by assessing the operations of the taxpayer. Please note that the mere presence of a server (even if it is a powerful one – that is, capable of concluding contracts, processing payments and delivery of goods and services in digital forms) in a particular jurisdiction without the involvement of human activity in that jurisdiction will not generally amount to the carrying on of business in Hong Kong. On the same token, the mere presence of server in Hong Kong does not constitute a permanent establishment here. In deciding the issue of whether a business is carried out in the territory, IRD will look beyond the fact of a server and examine the extent to which the person's other operations in Hong Kong have on tax assessment.

When determining the chargeability of profits, IRD will look at what the taxpayer has done to earn the relevant profits and where those activities are performed. The place where the automated server-based activity (e.g. provision of products and service information, processing of on-line purchase orders, delivery of digitized products or services, processing of on-line payments, etc.) is carried out does not, by itself, determine the chargeability of profits. These activities have to be weighted against the core business operations required to conduct the e-commerce transactions, which are usually carried out with a physical office (including operations arising from the need to automate, manage and control the virtual shop-front or back-office, etc).

## **5.7 Ceasing to Have a Business Presence in Hong Kong**

A business may choose to cease its presence in Hong Kong through a variety of ways. The time required and procedures will vary depending on the legal form of the business. The procedures for closing an unincorporated company are relatively simple. The business owner is simply required to notify IRD of the business cessation within one month from the cessation date.

On the other hand, a limited liability company has to submit its final accounts and Profits

Tax Return to IRD for assessment. After clearing of all outstanding tax obligations, the company can apply to the Business Registration Office for cancellation of its business registration. Lastly, it can proceed to close it down through members' voluntary liquidation or deregistration.

### 5.7.1 Members' Voluntary Liquidation

If the company is solvent (i.e. it can settle all its debts in full), it may cease its business by members' voluntary liquidation. The majority of the company's directors are required to sign and issue a certificate of solvency ("COS") within 5 weeks before commencing the liquidation process. Furthermore, a statement of assets and liabilities made up to a date of not more than two months before the issue date of the COS has to be embodied in the COS. The company must clear up all its assets and liabilities and has the legal disputes settled before commencing the members' voluntary liquidation. Otherwise, it will be very costly for the liquidator to realize its assets, settle its liabilities and legal disputes.

The duration of the liquidation procedures depends on a number of factors such as the time taken for getting tax clearance and distribution of surplus assets, etc. A company is dissolved on the expiration of 3 months from the registration of the return of final meeting with the Companies Registrar. In addition, under the Companies Ordinance, 5 years after the dissolution of a company, no liability shall rest on it, its liquidators or any person to whom the custody of books of accounts and related papers has been designated, by reason of any books of accounts or related papers not being available to any person claiming to be interested therein. Business owner is recommended to keep proper records for 5 years after the date of dissolution of the company.

### 5.7.2 De-registration of A Limited Liability Company

Alternatively, a limited liability company may cease business by simply applying for de-registration with the Companies Registry under Section 291AA of the Companies Ordinance subject to the fulfilment of the following criteria:-

- i. All members of the company agree to the de-registration;
- ii. The company has NEVER commenced business or ceased to carry on business for more than 3 months before the application;
- iii. The company has NO outstanding liabilities; and

- iv. The company has obtained the “Notice of No Objection” from the Commissioner of IRD.

The Companies Registrar will consider the application for de-registration upon receipt of a written confirmation from the company on the above-listed conditions. The company also has to obtain the Notice of No Objection from IRD confirming that it has no outstanding tax liabilities before it can apply for de-registration. Under normal circumstances, IRD will take about one month to issue the said Notice and the Companies Registrar about 5 months to process the de-registration application. Thus, it will take a total of about 6 months to complete the whole process. Pursuant to Section 291AB of the Companies Ordinance, the court may order that the Companies Registrar reinstates the registration of a company that was de-registered under Section 291AA if an application for reinstatement is made to the court within 20 years of the de-registration by a person who feels aggrieved by the de-registration.

### **5.7.3 Tax Consideration on Disposal of Business Assets**

Apart from closing down the business in Hong Kong, investors may dispose of its business assets to other buyers. Since Hong Kong does not have capital gain tax, any capital gain on disposal of a business will not be chargeable in Hong Kong. However, IRD will look at certain criteria to determine whether profit derived from the disposal is of capital nature or not. These criteria include the length of ownership in the business, circumstances leading to the disposal and the original intention of acquiring the business. If the IRD opines that the seller is actively engaged in the buying and selling of business assets in Hong Kong, they may deem the profit so generated as trading in nature and impose profits tax on it.

## **5.8 Double Taxation Agreements**

Unlike most of the tax regimes in the world, Hong Kong operates a territorial taxation system. It means that only profits derived from the territory are subject to tax in Hong Kong. Under such taxation system, Hong Kong residents are unlikely liable to double taxation in foreign countries as the income derived outside Hong Kong will be regarded as offshore sourced and therefore exempted from corporate tax in Hong Kong. On the same token, foreign residents, who are subject to tax in their home countries on worldwide basis, may apply for unilateral tax credit relief for any tax paid on income generated from their business in Hong Kong. Accordingly foreign residents with business operating in Hong Kong should not have the problem of double taxation.

Instead of entering into comprehensive double taxation agreements (“DTAs”) with other tax jurisdictions, Hong Kong has signed limited DTAs with other countries including Bangladesh, Belgium, Canada, Croatia, Denmark, Estonia, Germany, Israel, the Republic of Korea, Macao Special Administrative Region, Mauritius, the Netherlands, New Zealand, Norway, the Russian Federation, Singapore, Sri Lanka, Sweden, Thailand, the United Kingdom and the United States in order to avoid double taxation of certain controversial items such as income derived from international aircraft and shipping operations.

### 5.8.1 HK-PRC Double Taxation Agreement

Hong Kong has entered into an “Arrangement for the Avoidance of Double Taxation on Income” with the Central Government of PRC on 11 February, 1998. This agreement covers:

- . *Business profits of an enterprise that carries on business through permanent establishment;*
- . *Income from shipping, air and land transport; and*
- . *Income from personal services.*

After a lengthy discussion, the PRC Central Government and the Hong Kong Government signed an arrangement on 21 August, 2006 - the Arrangement for the Avoidance of Double Taxation on Income and Prevention of Fiscal Evasion. This arrangement extends the scope of the original agreement on business profits and income from personal services. It covers direct income earned by businesses and individuals (e.g. operating profits and employment income) as well as indirect income (e.g. dividends, interest and royalties) and ensures that the same income will not be doubly taxed in the two tax jurisdictions. Both governments have also entered into the Second Protocol to the Arrangement to clarify the different views on the interpretation of the Agreement on 30 January, 2008, which becomes effective on 11 June, 2008.

The arrangement provides added incentives for international investors to enter PRC market through Hong Kong. It also enhances cross-border financing arrangements and the transfer of technical know-how and patent rights between the two places. Under the new arrangement:

- . *Top rates for withholding tax for dividends received by a Hong Kong resident from investments in PRC enterprises will be reduced from 20% to 10%, and a Hong*

*Kong business from 10% to 5% if the Hong Kong business holds at least 25% of the shares in a PRC enterprise.*

- Top rates for withholding tax for interest received by a Hong Kong resident from PRC will be reduced from 20% to 7% and a Hong Kong business from 10% to 7%.*
- Top rates for withholding tax for royalties received by a Hong Kong resident and a Hong Kong business from PRC will also be reduced from the respective 20% and 10% to 7%.*
- The taxing right for gains received by a Hong Kong resident or a Hong Kong business from the transfer of shares in a PRC enterprise is allocated exclusively to Hong Kong. If the income does not amount to a trading receipt or is not sourced in Hong Kong, no profits tax will be charged in Hong Kong. In the case where the assets of the PRC enterprise are comprised mainly of immovable property situated on PRC or the shares transferred are equal to or exceed 25% of the shareholding of the PRC enterprise, the income may be taxed in both jurisdictions. However, a tax credit arrangement will effectively ensure that the same income will not be taxed twice.*

Please note that the arrangement contains an article on the exchange of information between the State Administration of Taxation and the Hong Kong Inland Revenue Department. This is essential to enable both parties to carry out the provisions of the arrangement. However, the information to be exchanged is limited to information that is necessary for carrying out the provisions of the domestic laws concerning taxes covered by the arrangement and therefore, taxpayers' information will not be abused.

### **5.8.2 HK-Belgium Double Taxation Agreement**

Recently, the attitude of Hong Kong Government has changed. She now recognizes that there are merits in concluding DTAs with her trading partners. A comprehensive DTA can provide certainty to foreign investors on their tax obligations in Hong Kong and their home countries. It can also help them to better assess their potential tax liabilities. Accordingly it is believed that the signing of DTA will create a mutually beneficial situation in which foreign investors are encouraged to do business in Hong Kong, and likewise, Hong Kong companies to do business in foreign countries.

On 10 December, 2003, the Hong Kong Government signed a DTA with the Belgian Government ("HBTDA). This is the first comprehensive DTA signed with a European

country. The HBDTA defines the taxing right of various items including dividends, interest, royalties, employment income, business profits and income from immovable property, etc. It also includes a provision governing the exchange of information between Hong Kong and Belgian tax authorities.

The HBDTA creates tax-planning opportunities to both European and Hong Kong investors:

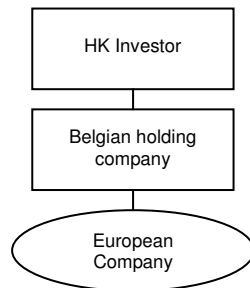
A. For Hong Kong Investors

HBDTA provides a more tax-effective way for them to structure their European investments. To take advantage of the HBDTA, Hong Kong companies may consider incorporating a holding company in Belgium for holding its investments in Europe (Diagram 1 refers).

Such two-tier structure offers the following advantages to the Hong Kong investors:-

- i. The Hong Kong investors can receive dividends, interest, and royalties from the Belgian holding company at a zero or reduced withholding tax rate.
- ii. The Hong Kong investors can take advantage of the double tax treaties signed by Belgium with other European countries. As Belgium is a member of the European Union (“EU”), the Belgian holding company can enjoy preferential tax treatment on dividend income received from other EU Members.

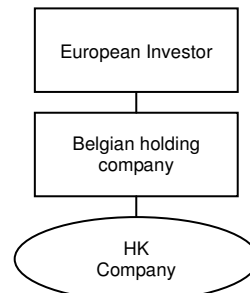
Diagram 1: Proposed investment structure for HK Investors



B. For European Investors

Similarly, European investors can take advantage of the HBDTA in structuring their Hong Kong investments. According to an Administrative Circular Letter issued by Belgian tax authorities on 31 March, 2005, the Hong Kong corporate tax regime is not considered as “substantially more advantageous” than the tax system in Belgium. It

Diagram 2: Proposed investment structure for European investors



follows that the Belgian Participation Exemption Rule will still apply for dividends received from Hong Kong subsidiaries. Accordingly, a Belgian holding company will only be subject to Belgian corporate income tax at 5% of the dividend income received from its Hong Kong subsidiary. The Belgian holding company can then distribute dividends to its European investors by taking advantage of the favourable tax treatment under the existing double tax treaties between Belgium and her EU Member countries (Diagram 2 refers).

In addition, although there is no withholding tax in Hong Kong regarding payment of interest and dividends to foreign residents, Belgian companies are able to enjoy a lower effective tax rate in their country on royalties income derived from Hong Kong. For example, a foreign resident company receiving royalty (assuming that no person carrying on a trade, profession or business in Hong Kong has at any time wholly or partly-owned the relevant property that produces the royalty) from a Hong Kong company is currently subject to an effective tax rate of 5.25% (i.e. 17.5% x 30%) on the gross payment. Under the HBDTA, a Belgian company receiving royalty from the Hong Kong company will be subject to a reduced withholding tax rate of 5% only.

### 5.8.3 HK-Thailand Double Taxation Agreement

Further to the signing of the HBDTA, the Hong Kong Government signed a DTA with the Thai Government (“HTDTA”) on 7 September, 2005. This is the second DTA that the Hong Kong Government has signed with an overseas tax jurisdiction. It is also the first comprehensive DTA concluded between Hong Kong and an Asian country.

Similar to the DTA signed with Belgium, the HTDTA defines the taxing right of various items, including dividends, interest, royalties, employment income, business profits and income from immovable property, etc. It also includes a provision governing the exchange of information between Hong Kong and Thai tax authorities.

The HTDTA also creates tax-saving opportunities for both Thai and Hong Kong investors:

#### A. For Hong Kong Investors

The HTDTA provides a more tax-effective way for them to structure their Thai investments. Before the signing of HTDTA, any profits remitted from the Thai branch of a Hong Kong company would be subject to 10% withholding tax in Thailand. After the signing of the HTDTA, the withholding tax is exempted by the Thai Government.

## B. For Thai Investors

Although there is no withholding tax in Hong Kong regarding payment of interest and dividends to foreign residents, Thai companies may be able to enjoy a lower effective tax rate in their country on royalties income derived from Hong Kong. For example, a Thai resident receiving royalty (assuming that no person carrying on a trade, profession or business in Hong Kong has at any time wholly or partly-owned the relevant property that produces the royalty) from a Hong Kong company for the use of, or the right to use, any copyright of literary, artistic or scientific work, is currently subject to an effective tax rate of 5.25% (i.e. 17.5% x 30%) on the gross payment for the year of assessment 2006/07. Under the HTDTA, a Thai company receiving royalty from a Hong Kong company for the above payment will be subject to a reduced withholding tax rate of 5% only.

The signing of HTDTA has positive impact to both Hong Kong and Thai investors doing business in their own country. It promotes trade and closer economic relationship between the two jurisdictions through provision of tax relief in the case of double taxation.

# Foreign Personnel



## 6.1 Entry into Hong Kong

A foreign individual wishing to come and work in Hong Kong must apply for a working visa. Applicants should submit their visa applications to the nearest Chinese consular mission in their place of residence or send their applications to the Hong Kong Immigration Department directly or through their sponsor in Hong Kong.

The following documents have to be submitted when lodging a visa application:-

- i. An application form ID(E) 936 with the relevant parts duly completed and signed;
- ii. A copy of the sponsor's Business Registration Certificate, Certificate of Incorporation and/or Memorandum of Incorporation and Articles of Association;
- iii. Financial standing of the sponsor or the sponsor's company (income tax returns, trading profit and loss accounts, profit tax returns);
- iv. Company staff list with salary offered and position held and a list of expatriate staff recruited overseas (including both present staff and staff that have left);
- v. A copy of the applicant's service contract or letter of appointment with details of post, salary and benefits;
- vi. Full description of the applicant's post;
- vii. Details with proof of applicant's academic qualifications and experience relevant to the post, e.g. copies of diplomas, certificates and testimonials;
- viii. A letter, with supporting proof from the employer (if possible), stating the reason why the post could not be filled locally;

- ix. If the applicant is to replace someone already working in Hong Kong, the personal particulars and next move (if known) of the person to be replaced should be given;
- x. If the applicant is to fill a new post, explain why his/her services is essential; and
- xi. Evidence of the applicant's past residence in Hong Kong (if any).

In addition to the above-mentioned documents, other information or documents in support of the application may be required by the processing officer should the case so require. It normally takes 4 to 6 weeks to process an application.

## **6.2 Salaries tax liabilities**

Since Hong Kong adopts the territorial tax principle, an individual's nationality and residency are irrelevant for considering his/her salaries tax liabilities in Hong Kong. Rather, the source of income (i.e. the place where the income is actually derived from) is the determining factor. The same set of tax rules and tax rates are applied to both local and foreign residents.

## **6.3 Mandatory provident fund scheme**

Hong Kong adopts Mandatory Provident Fund ("MPF") scheme. Therefore, it is an additional cost to foreign investors.

An employer in Hong Kong is required to make arrangements for relevant employees aged between 18 and 65, who have been employed for 60 days or more, to join a registered MPF scheme. It can select one or more MPF schemes managed by the licensed trustees in the market (e.g. most of the licensed banks and insurance companies in Hong Kong) and then arrange its relevant employees to join.

Mandatory contributions are calculated on the basis of 10% of an employee's relevant income. Employer and its employees are required each contributing 5% to the scheme. Maximum and minimum income levels have been set for mandatory contribution purposes. If the employee's income is less than HK\$5,000 per month, he or she will be exempted from making mandatory contributions but the employer is still required to contribute an amount equal to 5% of the employee's income. If the employee's income exceeds HK\$20,000 per month, the employer and the employee are only required to contribute each 5% against HK\$20,000 each (i.e. HK\$1,000 per month) to the scheme.

Of course, they can opt to make extra, voluntary contributions in addition to the mandatory contributions.

If employees belong to any one of the following categories of persons, the employer and the respective employees are NOT required to join a MPF scheme:

- i. Employees who have attained 64 years of age;
- ii. Household employees;
- iii. Self-employed hawkers;
- iv. People covered by statutory pension and provident fund schemes (e.g. Hong Kong civil servants and teachers);
- v. Members of occupational retirement schemes that are granted exemption certificates;
- vi. People from overseas who enter Hong Kong for employment for less than one year; or people from overseas who are covered by overseas retirement schemes; and
- vii. Employees of the European Union Office or the European Commission in Hong Kong.

Investors may visit the website of the MPF Authority (<http://www.mpfahk.org>) for more detailed information about the statutory requirements in Hong Kong.

## 6.4 Employee's rights

The Employment Ordinance is the main legislation governing conditions of employment in Hong Kong. It covers a wide range of areas in employment protection and benefits including:

- . Rest Days
- . Holidays with Pay
- . Paid Annual Leave
- . Sickness Allowance
- . Maternity Protection
- . Severance Payment
- . Long Service Payment
- . Employment Protection
- . Termination of Employment Contract
- . Protection Against Anti-Union Discrimination

The Labour Department is responsible for enforcing the Employment Ordinance with the mission to improving and safeguarding employees' rights and benefits in an equitable manner. Employees have the right to sue an employer for breach of employment contract or any non-compliance with the Employment Ordinance. Employees can either submit their claims to the Minor Employment Claims Adjudication Board set up by the Labour Department (for minor claims) or to the Labour Tribunal under the Judiciary which provides a quick, inexpensive and informal forum for settling labour disputes.

## **6.5 Individuals leaving Hong Kong**

A foreign individual, who will cease to be employed in Hong Kong, has to clear his or her tax obligations before leaving Hong Kong.

An employer is required to notify IRD, at least one month before the expected departure date of the employee, by completing and filing the Form IR56G to IRD. The employer is also required to withhold all monies payable to the employee within one month from the date of filing the Form IR 56G. After receiving the notification from the employer, IRD will issue Individual Tax Return to the individual for completion and conduct assessment of him or her upon receiving the completed return. Upon settlement of salaries tax by the individual, IRD will issue a written consent to the employer (the "Letter of Release") for releasing the money withheld.

# Doing Business In PRC Through Hong Kong



## 7.1 Overview

Low tax rates, simple taxation system, free port and free economy, competent legal system, good infrastructure and financial system, excellent geographic location... these may be the general impressions that foreign investors would have when thinking about Hong Kong. In recent decades, due to the rapid economic growth and economic open-up policy of PRC, Hong Kong faces with keen competition from her motherland. Nevertheless, PRC also brings great opportunities to Hong Kong as her closer economic relationship attracting foreign investors to set up headquarters or liaison offices in the territory for managing their investments in PRC and Asia. The signing of the Closer Economic Partnership Arrangement (“CEPA”) in 2003 and various supplementary agreements concluded later further enhance Hong Kong’s position as the foreign investment gateway to PRC.

## 7.2 Hong Kong – a unique city in PRC

Hong Kong - It is the freest economy in the world situated in the global fastest growing nation, PRC. She is a unique territory compared with other PRC cities because the former operates a totally separate legal and administrative system. Under the “One Country, Two Systems” policy, Hong Kong retains its own legislative and capitalist system and enjoys high autonomy on its administrative affairs. She inherits the British common law system, which provides great confidence to foreign investors.

Moreover, Hong Kong is almost the lowest tax region in the world, which is also an international commercial, logistics and financial centre. This means any tax efficient arrangement and the resulting accumulation of profits in Hong Kong can be easily justified on commercial grounds to the tax authorities of many home countries of the foreign investors. Hong Kong does not have restrictions on foreign exchange. There

is neither dividend tax nor capital gain tax.

Foreign investors therefore prefer setting up regional headquarters in Hong Kong where they carry on active business and accumulate funds for financing their future expansions in the Asia Pacific Region.

### **7.3 CEPA – better market success and more savings on tariffs**

On 29 June, 2003, Hong Kong Government signed the “Closer Economic Partnership Arrangement” (“CEPA”) with the Central Government of PRC. Companies in Hong Kong can benefit from reduction of tariff rates for goods exported from the territory and gain preferential and accelerated market access to key service sectors in PRC. A number of supplementary agreements were signed afterwards providing further liberalization measures.

According to CEPA, PRC agrees to apply zero import tariffs on imports of all finished products (except prohibited articles and articles that are subject to special requirements) from Hong Kong provided that they satisfy the rules of origin requirement as “Made in Hong Kong”. In general, goods are qualified as made in Hong Kong if they have been “*wholly obtained in Hong Kong*” or “*substantially transformed*” in Hong Kong.

The Hong Kong Trade and Industry Department is authorized by the Hong Kong Government as the certification organization to issue the Certificates of Origin under CEPA to qualified applicants. When determining whether or not the goods are “substantially transformed” in Hong Kong, they will look at several criteria (Table 1 below refers). However, it is stated in CEPA that simple diluting, mixing, packaging, bottling, drying, assembling, sorting, decorating as well as processing or treatment for the purpose of transportation, storage, delivery, packaging or display are not regarded as substantial transformation.

CEPA also provides liberalization to Hong Kong-based companies, ahead of the WTO timetable, in market access of various service sectors in PRC. To be eligible for enjoying the benefits, a company must be a qualified “Hong Kong Service Provider” which means that it must be incorporated in Hong Kong with “substantial business operations” in the past 3 to 5 years, subject to Hong Kong profits tax and having employed at least 50 percent of local staff in Hong Kong.

Under CEPA, qualified Hong Kong enterprises and individuals have earlier access and, to a certain extent, more privileges than will ultimately be available when doing business

with PRC under the agreements made with WTO. The CEPA benefits are exclusive to Hong Kong. It is expected that CEPA will strengthen Hong Kong's position as the ideal location from which to do business with PRC. It can also bring new business opportunities to Hong Kong by enhancing Hong Kong's position as the international trade and service centre and opening up the door for Hong Kong companies to explore the PRC market.

**Table 1: Criteria for assessing whether or not goods are “substantially transformed” in Hong Kong**

Criteria	Description
1. Manufacturing or processing operations	The principal manufacturing or processing operations are carried out in Hong Kong which confer essential characteristics to the goods derived after the operations.
2. Change in tariff heading	The processing and manufacturing operations of non-originating materials are transacted in Hong Kong and resulting in a product with a different four-digit tariff heading under the “Product Description and Harmonized System Codes”. In addition, no production, processing or manufacturing operations will be carried out in countries or territories other than Hong Kong which will result in a change in the four-digit tariff heading.
3. 30% valued-added content	The total value of raw materials, component parts, labour costs and product development costs exclusively incurred in Hong Kong being greater than or equal to 30% of the FOB value of the exporting goods, and that the final manufacturing or processing operations should be completed in Hong Kong. The formula for calculation is as follows:- $\frac{\text{Value of raw materials} + \text{value of component parts} + \text{labour costs} + \text{product development costs}}{\text{FOB value of the exporting goods}} \times 100\% \geq 30\%$
4. Other criteria	Methods other than those set out in (1) to (3) above.
5. Mixed criteria	Use of two or more of the above criteria.

## 7.4 Making use of Hong Kong Company as an investment vehicle to invest in PRC

Hong Kong remains as one of the most popular places in which foreign investors prefer to incorporate investment vehicle to hold their PRC investments. The statistics announced by the PRC Government reflect that Hong Kong has been ranked in consecutive years as the top source of foreign investments in the PRC in terms of total number of projects and total amount of investment.

There are several major reasons for foreign investors incorporating Hong Kong companies as the investment vehicles to hold their PRC investments:-

- i. The use of Hong Kong investment vehicle can give foreign investors more confidence in investing in PRC as the vehicle will be governed by the Hong Kong Companies Ordinance which is very similar to the corporate laws of the developed countries.
- ii. Hong Kong is one of the major financial centres in the world, which possesses mature banking and financial systems. Banks in Hong Kong possess good knowledge of the PRC business environment and most of them have already established branches in the PRC cities. It is usually easier for foreign investors to raise funds in Hong Kong for financing their PRC investments.
- iii. Foreign investors wishing to dispose of their interests in the PRC investments can do so through the disposal of their shares in the Hong Kong vehicles. Hence, it avoids capital gains tax arising in PRC. Capital gains are not tax chargeable in Hong Kong.
- iv. The above two-tier investment structure allows reorganisation (if necessary) of foreign investors' interests at the Hong Kong company level without reverting to the tedious re-registration procedures in PRC.
- v. Any dividends distributed by Hong Kong investment vehicle to its shareholders will be fully exempted from tax in Hong Kong. As such, there is no withholding tax requirement.

Hong Kong has been positioned as the gateway between the Mainland China and foreign countries for more than one century. Thousands of international companies involved in PRC trade have already established their beachheads in Hong Kong. According to the statistics of the Hong Kong Government:

- . *Hong Kong is the largest overseas investor in PRC accounting for 45% of all the overseas-funded projects by the end of 2007 ;*
- . *Hong Kong ranked the third largest trading partner of PRC accounting for 9% of its total trade in 2007;*
- . *Around 62% of Hong Kong's re-exports were originated from and 49% were transported to PRC in 2007;*
- . *453 PRC companies are listed on the Stock Exchange of Hong Kong as of October 2008; and*
- . *At least 2,000 PRC government-backed companies are registered in Hong Kong.*

Hong Kong is located at the centre of Asia. Taking a flight from the Hong Kong International Airport, business executives can reach most Asian countries within five hours. They can also travel to and from Beijing, Shanghai and other major PRC cities in a single day while making their home in Hong Kong.

For all these reasons, not only foreign investors but also PRC domestic enterprises like to choose Hong Kong as their stepping stone to do business in PRC from tax and commercial perspectives. They endeavour to establish companies in Hong Kong and channel their funds to Hong Kong, which are then invested in overseas markets or re-invested in PRC. It is anticipated that more and more PRC domestic enterprises will establish their presence in Hong Kong.

# Useful contacts



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