This publication is a joint project with PwC

HSBC Commercial Banking

Doing business in Hong Kong

Contents

Executive summary

Hong Kong, which has been ranked the 'World's Freest Economy' for over a decade, is a regional business hub in Asia. Hong Kong's proximity to China, its similarities in terms of culture, social customs and language, and its international business environment, have made it an ideal base for foreign investors to enter the Chinese market. These characteristics also help mainland investors to invest in regional and global markets. Hong Kong continues to be Asia's second largest and the world's third largest Foreign Direct Investment recipient.

Based on the World Bank Doing Business Survey, Hong Kong is ranked second in terms of ease of doing business in the world. It offers a number of competitive advantages as a hub for investors to conduct their business, such as:

- The Hong Kong Government has long been endorsing a 'market driven with minimal government interference' policy. Foreign investment is welcome and there is no policy to protect the local industry against foreign competitors. The Hong Kong business community is also receptive to foreign investment.
- Strategically located at the centre of Asia, all of the region's key markets are within a 4-hour flight and half of the world's population is within a 5-hour flight. Hong Kong's International Airport is one of the busiest international airports in the world, with direct flights to over 160 international destinations.
- Hong Kong's proximity to, and close and unique relationship with, mainland China, has made it the gateway to mainland China for business. English is the language of business in Hong Kong and many people speak English, Cantonese and Putonghua and have a good understanding of international and mainland Chinese business.
- Although no particular aspects of Hong Kong's tax regime favours foreign investment and there are no significant tax incentives for foreign investment, Hong Kong's low and simple tax system is attractive to foreign investors. The corporate tax rate and income tax rate are capped at 16.5% and 15% respectively, with no turnover tax and no tax on capital gains or dividends.
- Hong Kong is a free port and generally imposes no customs duties on imported goods, with a few limited exceptions.
- Hong Kong's immigration policies are designed to attract professionals, talented individuals and investors to ensure the city's continued competitiveness and enrich the quality of Hong Kong's workforce. Hong Kong's labour force has not been known to voice any objections against foreign investment.

While the Hong Kong Government has adopted a policy of minimum intervention towards the regulation of the territory's business and industry, investors still need to be aware of regulatory aspects relating to their specific sector, where appropriate. This document contains reference to some common issues that investors should be aware of when operating in Hong Kong and/or using Hong Kong as a gateway to mainland China, although specific advice on their particular circumstances should be sought.

Foreword

In today's world, businesses must compete on a much wider playing field, no longer confined within national borders.

Since the 1950s, we have witnessed the rise of dynamic Asian economies starting with Japan and then spreading in the 1960s and 70s to the Asian Tigers – Hong Kong, Singapore, Taiwan and South Korea. While their economic success has brought tremendous prosperity, it is safe to say that none attracted the same attention as the rise of China has in the last 20 years. The awakening of the Chinese dragon is, to borrow the words of Napoleon two centuries ago, 'shaking the world'.

Today, China is the second largest economy in the world after the United States and is the fastest-growing major economy. Not only has China become the workshop of the world, the country's increasingly affluent population is becoming a significant consumer market itself.

Founded in Hong Kong and Shanghai in 1865, HSBC has over 140 years expertise in helping customers to seize business opportunities in China. Backed by our global presence in 84 countries and territories with around 6,900 offices worldwide, we are well positioned to assist entrepreneurs, multinationals and conglomerates eager to tap into this exciting and booming market.

Created in collaboration with PricewaterhouseCoopers, this guidebook, Doing Business in Hong Kong, provides a thorough analysis of various options in establishing a business in China. It underscores Hong Kong's strategic importance for doing business in China, explains the taxation systems, and also takes you through the process of setting up a company in Hong Kong and in the Mainland.

As your trusted partner, HSBC is always looking for ways to facilitate your business growth. With this guide, I hope you find building your venture in China has fewer complexities than you thought and I wish you a prosperous future in the land of dragons!

Peter Wong
Chief Executive, Asia Pacific
The Hong Kong and Shanghai Banking Corporation Limited

Introduction

Doing business in Hong Kong

Free trade is the lifeblood of Hong Kong. It is one of the most open and externally orientated economies in the world.

Unrivalled location

Hong Kong has a prime location at the geographical and economic centre of Asia. Business executives in Hong Kong have fast and easy access to all the major markets in the region. This central position is one of the key reasons for the city's popularity as a location for regional operations.

Hong Kong International Airport is repeatedly voted as one of, if not the best airport in the world. It operates on a 24-hour basis, with daily non-stop flights to major cities in Asia Pacific, North America, Europe, the Middle East and South Africa. Travelers can reach most countries in Asia within a five-hour flight.

Located on the southeast coast of mainland China, Hong Kong fronts a vast hinterland that is, with 1.3 billion people, the largest single market in the world. Corporate executives can travel back and forth to Beijing, Shanghai and other major Chinese cities in a single day while making their home in Hong Kong. For companies with manufacturing facilities in the Pearl River Delta (PRD region), their executives can travel there by car in one to three hours. In addition, the Guangzhou-Shenzhen-Hong Kong Express Rail Link is under construction with journey times from Hong Kong to Guangzhou only 48 minutes.

Gateway to China

Hong Kong is blessed with an invaluable geographic advantage – its proximity to mainland China. Flanking the mouth of the PRD, Hong Kong has served as the gateway to China for more than a century and a half. There is nowhere better than Hong Kong to obtain the expertise, information and facilities needed to tap into the immense Chinese market.

China's entry to the World Trade Organisation and development of increasingly competitive industries have set the stage for even greater economic expansion. The Closer Economic Partnership Arrangement (CEPA), which took effect at the beginning of 2004, provides Hong Kong with additional and exclusive market access benefits.

The marriage of Hong Kong's world-class financial, marketing and technical expertise and sophisticated infrastructure with the Mainland's rapidly developing manufacturing and services base has created a win-win situation. China is now Hong Kong's largest trading partner, and thousands of international companies involved in China trade have chosen to establish their beachhead in Hong Kong.

The Heritage Foundation, The Wall Street Journal and the Cato Institute in the United States and the Fraser Institute of Canada have consistently rated Hong Kong as the world's freest economy.

- The cornerstone of the economy rests on free enterprise, free trade and free markets open to all.
- No barriers to trade – no tariffs, no quotas, no exceptions.
- No restrictions on investments inward or outward.
- No foreign exchange controls.
- No nationality restrictions on corporate or sectorial ownership.

Contents of this section are adapted from the website of Invest HK www.investhk.gov.hk as of May 2012.

Rule of law

The rule of law is fundamental to Hong Kong's success. All are equal before the law. The legal system of the Hong Kong Special Administrative Region (HKSAR) is separate from the Mainland's. The impartial judiciary is independent of the legislative and executive branches, and is drawn from several British Commonwealth jurisdictions as well as from Hong Kong itself. Cases are heard in English and/or Chinese.

The Basic Law came into effect when China resumed sovereignty of Hong Kong in mid-1997 and serves as the region's constitutional framework. Its underlying premises are best summed up as 'One Country, Two Systems' and 'No change for 50 years'. Post-1997 Hong Kong inherited the laws of the former colony so that Hong Kong today continues to benefit from a stable and mature legal system, covering such business-critical areas as intellectual property.

Court of Final Appeal

The Court of Final Appeal operates in Hong Kong and is staffed by senior judges from Hong Kong and distinguished overseas judges on rotation. It is the highest appellate court which hears appeals in both civil and criminal matters and may confirm, reverse or vary the decision of the lower courts in Hong Kong. Foreign affairs, defence and Chinese constitutional issues are the responsibilities of the sovereign state, China.

Arbitration

Hong Kong has developed into one of the world's major arbitration centres since establishing its International Arbitration Centre in 1985. Its expertise in commerce, finance, shipping and construction provides the necessary pool of experienced professionals to promote dispute settlements. These include accountants, architects, bankers, engineers and insurance experts, as well as lawyers.

Police

Hong Kong has long been a safe city with low crime rates. Crucial to this achievement is its effective and efficient 37,000-strong police force.

Clean government

Hong Kong is one of the most corruption-free economies in the world. Cronyism, influence-peddling and bribery receive zero tolerance here. This is due to its strong public administration as well as the Independent Commission Against Corruption (ICAC). Since it was founded in 1974, the ICAC has promoted a strong anti-corruption culture in Hong Kong. Clean government practices ensure that companies are free to pursue their business interests on a level playing field without concern for corruption.

Free flow of information

Freedom of information is another core advantage that Hong Kong offers businesses. From obtaining a driving licence to checking your Facebook account, reading the daily news or researching potential business partners, Hong Kong is committed to transparent, timely and reliable information.

Hong Kong enjoys constitutionally guaranteed freedom of speech and freedom of the press. Information about government services is easily available online and there is unrestricted access to the internet.

World-class infrastructure

People in Hong Kong take it for granted that everything works properly.

The electricity grid is state-of-the-art and supply is more than adequate. Blackouts are not part of the vocabulary. Drinking water is readily and reliably available. Taxis operate around the clock. Mobile phones connect – even in tunnels and in the underground railway.

The telecommunications system is fully digitised. The government began deregulating the industry as early as 1995 when it issued fixed-line telecommunications network service licences to four providers.

The mobile phone services market is very competitive with five operators and 18 networks. There are currently 187 internet service providers in Hong Kong, all are allowed to provide broadband services under their licences. Broadband internet connection virtually covers all households and commercial buildings.

The only modern, fully-developed deep-water harbour between Singapore and Shanghai, Hong Kong is the focal point of all maritime activities in southern China. The container port in and around Kwai Chung is privately owned. In the fourth quarter of 2011, Hong Kong handled a total of 6.2 million TEUs. Vessel turnarounds are among the fastest in the world and port charges are among the lowest worldwide. Container ships at terminal berths are routinely turned around in about ten hours, while the turnaround time for conventional vessels working in mid-stream at buoys or anchorages is 25 and 37 hours respectively.

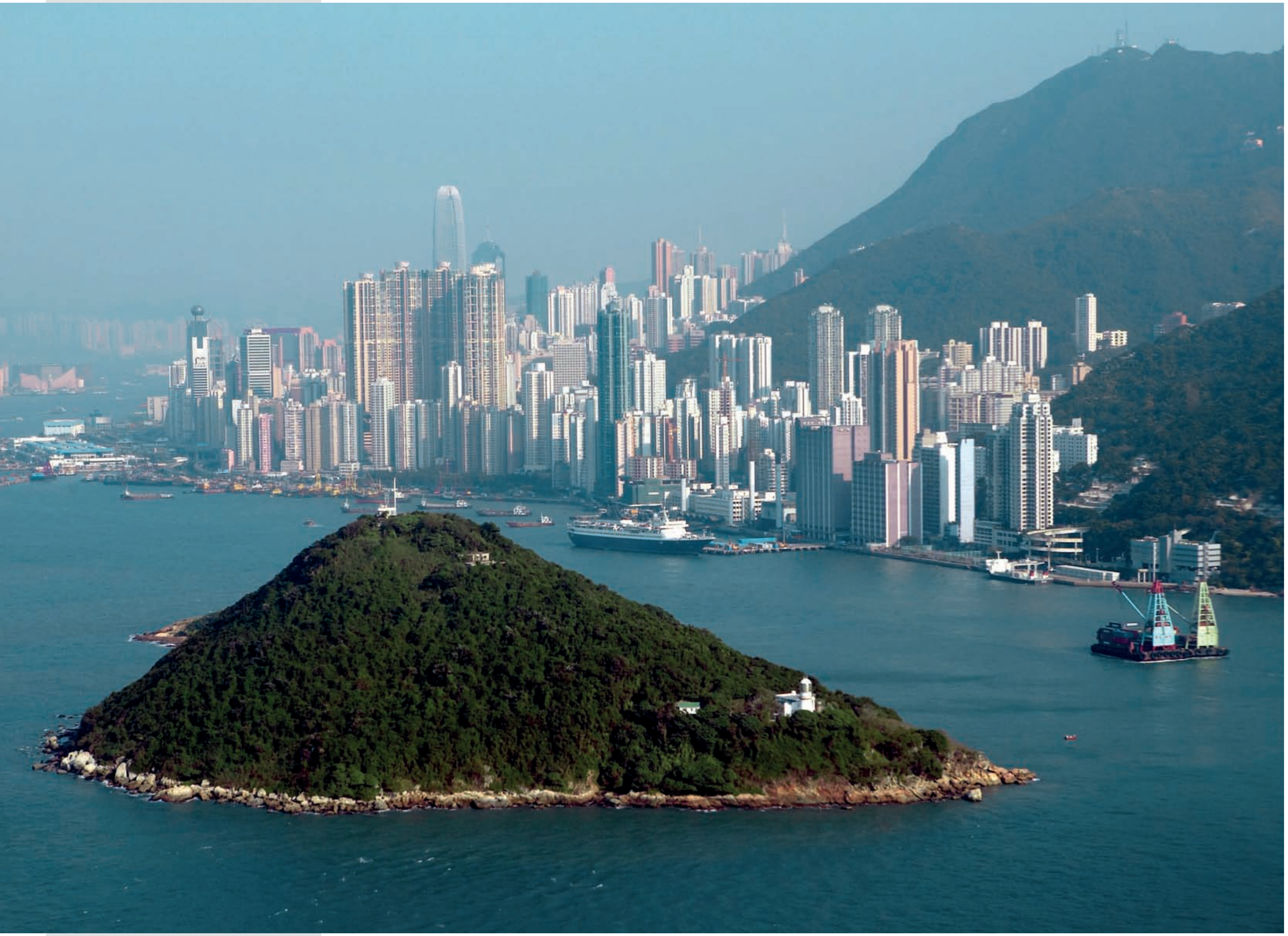
The state-of-the-art Hong Kong International Airport is just 23 minutes from the central business district by a high-speed rail link. Opened on 6 July 1998, it is one of the world's busiest airports and can process about 53.9 million passengers and 3.9 million tonnes of air cargo annually. Besides, as part of the Hong Kong International Airport Master Plan 2030, the Airport Authority ('AA') recommended that the government build an additional runway as the two existing runways are forecast to reach capacity by 2020. With the government's approval, AA will proceed with an Environmental Impact Assessment process and the preparation of the associated design details of the facilities under a three-runway system.

International lifestyle

Hong Kong offers a stimulating, dynamic and cosmopolitan lifestyle, but it also has its tranquil side with lush countryside and remote beaches accessible only from the sea. Some 40% of Hong Kong is protected as country and marine parks and shielded from development. The marshlands in the north of the territory shelter one of the widest varieties of birdlife in the world. Botanists and zoologists are still finding hitherto unrecorded species of flora and fauna.

It's a city of eastern and western cultures, with an abundance of arts centres, museums, concert halls and libraries. The annual Hong Kong Arts Festival and

Hong Kong maintains a stable and mature legal system covering such business-critical areas as intellectual property.



other cultural events all year round feature top performers from around the world. It's also the food capital of China, with every regional cuisine celebrated, and a city with well-developed international tastes. Whatever one fancies, whether it's haggis or sushi, French haute cuisine or burgers, falafel or pizza, diners are spoilt for choice.

Low taxes

Hong Kong taxes are among the lowest in the world, and the tax regime is simple and predictable.

The profits tax rate is the same for foreign and local companies – a low 16.5%. The actual tax bill is often even less after various deductions and depreciation allowances.

There is no capital gains tax, withholding tax on dividends and interest or collection of social security benefits in Hong Kong.

The salaries tax is charged at either progressive rates of 2% to 17% or a standard rate of 15%, and is imposed only on income from employment, office or pension of individuals arising in or derived from Hong Kong. The salaries tax is assessed on a yearly basis and can be paid in two instalments, usually between January and April of the following year.

The property tax applies to owners of land or buildings situated in Hong Kong. It is low by international standards: 15% (from 2008/09 onwards) of the rental income from the land or buildings with an allowance of 20% permitted for the cost of repairs and maintenance.

There is no sales tax or VAT in Hong Kong. The limited tax base, combined with exceptionally low tax rates, makes Hong Kong's tax incidence much lower than in virtually all other developed economies.

Why set up a business in Hong Kong for investing in mainland China?

Hong Kong is one of the best cities for businesses. It has one of the most flexible and supportive corporate governance regimes in the world.

Advantages of entering China via Hong Kong

The following are some advantages of using Hong Kong companies for investing in China.

Double Tax Agreement (DTA) – Comprehensive DTA between China and Hong Kong

China and Hong Kong entered into a comprehensive DTA in August 2006 to replace the limited scope agreement signed in 1998. The comprehensive agreement took effect on 1 January 2007 in China and on 1 April 2007 in Hong Kong.

Provisions in the comprehensive agreement provide beneficial treatments for Hong Kong companies investing in China (e.g. reduced withholding tax rates on dividends, interest, royalties and exemption treatment for certain capital gain). The table below briefly illustrates the tax benefits relating to dividends for a foreign investor (Parent Company) to invest in China via a Hong Kong holding company.

	Scenario 1 Parent Company Directly Investing into China	Scenario 2 Parent Company Investing into China via a Hong Kong Holding Company
China Operating Company		
Profit before tax	100	100
China CIT	100 x 25% = 25	100 x 25% = 25
Distributable dividend	100 – 25 = 75	100 – 25 = 75
Hong Kong Holding Company		
China withholding income tax	N/A	75 x 5%[2] = 3.75
Distributable dividend	N/A	75 – 3.75 = 71.25
Parent Company		
China withholding income tax	75 x 10%[1] = 7.5	N/A[3]
Total dividend received	75 – 7.5 = 67.5	71.25
Overall China and Hong Kong tax burden	32.5	28.75

Notes:
1. The withholding income tax rate on dividends under China's domestic tax law is 10%.
2. The withholding income tax rate on dividends is 5% under the double tax agreement between China and Hong Kong if the Hong Kong Holding Company owns not less than 25% capital of the China Operating Company.
3. Hong Kong does not levy withholding income tax on dividends.

In this example, it is assumed that the Parent Company is from a country/state that does not have a tax treaty with China. In addition, the tax implications in Parent Company's home country are ignored for simplicity purposes.

It is worth noting that the Chinese tax authorities have recently geared up their efforts to attack business arrangements that are established for the purpose of tax avoidance. As such, it is imperative for the Parent Company to have justifiable commercial reasons to establish the Hong Kong Holding Company and also maintain sufficient commercial substance in the Hong Kong Holding Company in order to enjoy the preferential treatment under the China/Hong Kong DTA.

Hong Kong is an important offshore RMB and international financial centre.

Closer Economic Partnership Arrangement (CEPA) – Opportunities for Hong Kong

CEPA is the first free trade agreement concluded between China and Hong Kong. Under CEPA, both sides have agreed to enhance co-operation in trade and investment promotion in order to improve the overall business environment. Hong Kong Service Suppliers (HKSS) can enjoy greater liberalisation measures compared to foreign investors when entering China's service sectors.

Professional bodies in Hong Kong and the regulatory authorities in China have also signed a number of agreements or arrangements on mutual recognition of professional qualifications.

Since the signing of the main text of CEPA in June 2003, another eight supplements have been signed between 2004 and 2011 to further enhance the liberalisation measures for various service sectors. CEPA provides a window of opportunity for Hong Kong businesses to gain greater access to the Mainland market. Foreign investors with business establishments in Hong Kong may leverage on the CEPA benefits to tap the vast opportunities of the Mainland market.

RMB offshore centre

Hong Kong plays a vital bridging role for money flows between China and the rest of the world. In 2004, Hong Kong became the first place outside China to conduct personal renminbi (RMB) business. Since then, the Hong Kong Government has been actively exploring with Mainland authorities the introduction of new types of RMB business in Hong Kong with an aim to further enhance the capability of Hong Kong's financial system to handle RMB-denominated transactions. The Chinese Government also actively supports the growth of the RMB market in Hong Kong.

Starting from July 2011, eligible enterprises in China can settle cross-border trade in RMB with their trading counterpartners in all foreign countries and jurisdictions.

This further strengthens the status of Hong Kong as an important offshore RMB and international financial centre.

How to start a business in Hong Kong for investing in mainland China

Setting up a business in Hong Kong is straightforward. Procedures are transparent and simple.

Establishing an entity in Hong Kong

Forms of foreign investment

The principal forms through which a business can be conducted in Hong Kong are as follows:

1. Company incorporated in Hong Kong (either private or public via listing on the Stock Exchange of Hong Kong).
2. Branch of a foreign company.
3. Representative or liaison office of a foreign company.
4. Joint venture (can be set up either as a company or partnership).
5. Partnership.
6. Sole proprietorship.

Of the above, privately incorporated companies and branches of foreign companies are most commonly used by foreign investors.

Process

As a result of the government's policy of encouraging free enterprise, formalities for company incorporation and business registration are kept to a minimum. To incorporate a company, the first step is to check the index of company names at the Companies Registry to see whether the proposed name has already been registered. If the name is not the same as one already appearing on the index of company names and is not a name that requires the prior consent of the Chief Executive, the duly signed incorporation documents can be submitted to the Registrar of Companies for registration.

Effective from 11 July 2008, particulars of the first directors and first secretary of the company to be incorporated and place of its registered office (which must be in Hong Kong) are required to be reported in the incorporation documents. If the proposed names are acceptable for registration under the Companies Ordinance, the company will then be registered and the certificate of incorporation will be issued.

The Companies Registry and the Inland Revenue Department jointly implemented the 'One stop Electronic Company Incorporation and Business Registration Service' on 18 March 2011. Any person who applies for incorporation of a local company will be deemed to have made a simultaneous application for business registration. Normally the Certificate of Incorporation and the Business Registration Certificate can be issued within 24 hours of online application or 4 working days of paper submission.

The Business Registration Certificate must be renewed annually at the current rate of HK$2,450 (HK$2,000 is waived for the fiscal year 2012/13). A capital fee payable to the Registrar of Companies upon incorporation is HK$1 per HK$1,000 of authorised capital (subject to a maximum fee of HK$30,000).

In addition to the above requirements, a public company must file a prospectus, or statement in lieu thereof, before it allots any shares.

It is also possible to purchase 'ready-formed' private companies. Also known as 'shelf' companies, these are companies formed in advance of them being acquired by an investor. The attraction is principally one of time, since the shelf company is immediately available to trade or enter into contracts.

Under the Companies Ordinance, a foreign corporation establishing a place of business in Hong Kong must register with the Registrar of Companies as a non-Hong Kong company and file, inter alia, a copy of the corporation's certificate of incorporation, charter and bylaws, the latest published accounts and a specified form containing the information of each director and secretary, the name and address in Hong Kong of a person resident in Hong Kong who is authorised to accept on behalf of the foreign corporation service of process and any notices served on the corporation etc, within one month from having established a place of business in Hong Kong. A certificate of registration will be issued upon completion of the registration (usually 14 working days from the date of filing the above documents). A foreign corporation is required to be registered under the Business Registration Ordinance within one month from its date of commencement of business in Hong Kong.

Setting up an entity in Hong Kong

To determine the form of presence to be established in Hong Kong

A private limited company OR a branch of foreign company?

To establish a private limited company	To register the foreign company as a non-Hong Kong company (a Hong Kong branch)
Do a name search at the Companies Registry (CR)	Do a name search at the CR
Prepare draft Memorandum and Articles of Association (M&A), incorporation form and Notice to Business Registration Office	Prepare a statutory form and certified copies of the corporate documents of the foreign company
Submit the signed M&A, incorporation form and the Notice to the CR online or in paper form for registration	Submit the signed statutory form and certified documents to the CR for registration
A certificate of incorporation and a Business registration certificate to be issued to the company simultaneously	A certificate of registration to be issued to the company
	Apply for a business registration certificate for the branch

Facts at a glance

- The most commonly used business vehicles for doing business in Hong Kong are private limited companies and branches of foreign companies.
- The procedures for incorporation of a new private limited company and registration of a branch of foreign company in Hong Kong are simple and straightforward.
- The time frame for incorporation of a limited company can be as short as 24 hours for online applications, whilst it takes about 14 days to register a foreign company as a non-Hong Kong company in Hong Kong.

Establishing an entity in mainland China

Forms of foreign investment
The most direct way to penetrate into the Chinese market is to set up local presence. There are various forms of investment vehicles available to suit different business objectives and operations. Below are the major forms of investment vehicles that can be set up by foreign companies (including Hong Kong companies) in China:

1. **Representative Offices (ROs)**
Setting up a RO is one of the simplest ways to get into China and gain on-the-market experience. Legally, ROs are to be established purely for liaison purposes, and their activities are limited to the provision of services that do not give rise to any earnings.

2. **Equity Joint Ventures (EJVs)**
An EJV is a Chinese legal entity that takes the form of a limited liability company established in China. The partners have joint management of the company, and the profits and losses are generally distributed according to the ratio of each partner's capital contribution. Capital repatriation before the termination of the EJV is not allowed.

3. **Cooperative Joint Ventures (CJVs)**
A CJV can operate as a non-separate legal entity, although the parties to the venture may apply for approval to have the company structured as a separate legal entity with limited liability. Sharing of profits and losses may be agreed between the investing parties separately from the proportion of capital contributions. If all assets revert to the Chinese partner at the termination of the venture, capital repatriations of the foreign partner are permitted over the life of the CJV.

4. **Wholly Foreign Owned Enterprises (WFOEs)**
WFOEs are those established exclusively with the foreign investor's capital. However, there are a few industries which are still restricted to joint venture and WFOEs are not allowed.

5. **Joint Stock Companies (JSCs)**
JSCs, also known as companies limited by shares, are established primarily for listing on Chinese or foreign stock markets. The capital stock of a JSC is made up of equal value shares. Contributions are made by both domestic and foreign shareholders.

EJVs, CJVs, WFOEs and JSCs are generally referred to as foreign investment enterprises (FIEs) in China. Profits of FIEs can be remitted abroad. Foreign companies are also allowed to set up partnership enterprises in China. Under 'The Company Law of the Peoples' Republic of China' (the PRC Company Law), a foreign company may establish branches in China. However, in practice, only foreign financial institutions have been granted licences to operate branches.

Process

Setting up in China
In general, ROs and partnership enterprises are only required to be registered with the State Administration of Industry and Commerce (SAIC) or its local counterparts, whereas the FIEs are subject to approval by the Ministry of Commerce or its local counterparts before performing business registration with SAIC. Additional pre-approvals and special licences may be required for certain industries, such as banking, insurance and construction.

ROs, FIEs and partnership enterprises have to comply with post-establishment registrations, such as registration with local tax authorities, before they can become operational.

A foreign company shall take the following steps in order to set up in China:

- Verify the feasibility and prerequisites for setting up because they could be subject to local differences in practices and interpretations of the law.
- Optimise the tax-effectiveness of its shareholding structure and funding arrangements.
- Formulate an appropriate business scope to cater for the intended activities in China.
- Ensure the application documents for submission are complete, accurate and in the right format.
- Ascertain the appropriate channel for approval and registration and go through them one by one.

Capital structure

- FIE is required by China laws and regulations to have a registered capital and a total investment. Registered capital refers to the amount of equity contributed by the investor(s) that is registered with the business registration bureau and has to be actually paid up. Total investment refers to the amount of funds required to establish and operate the enterprise.
- The registered capital contributed to the enterprise can be used as working capital for daily operating purposes, e.g. salaries, rental, purchase of office equipment etc. The form of capital contribution can be in cash and/or in kind (e.g. by way of machinery and equipment, intangibles etc). At least 30% of the capital should be contributed in cash.
- Based on the PRC Company Law, in general, the minimum registered capital for setting up an enterprise ranges from RMB30,000 to RMB100,000, but this could be higher if the enterprise is engaged in a special industry. In practice, there could also be variations on the registered capital required depending on the local practice of the particular city where investment is to be made.

Time frame

The approval time frame would depend on the type of entity to be set up. Usually, it would take around one to two months for setting up a RO and may take around three to five months for setting up a JV or a WFOE.

Facts at a glance

- Major forms of investment vehicles include representative offices, equity joint ventures, cooperative joint ventures, wholly foreign owned enterprises, joint stock companies and partnership enterprises.
- Before setting up in China, a foreign company should review its current investments and future business plans to determine the optimal investment vehicle to set up in accordance with the current China investment regulations and specific industrial policies.
- The investor should formulate a business scope, prepare the relevant application documents and submit the application documents to the relevant approval and registration authorities for setting up a company in China.
- Timeframe for the set-up depends on the type of investment vehicle to be set up.

Taxation in Hong Kong

Taxation in Hong Kong is low. Offshore income, capital gains and dividends are not taxed.

Basis of taxation

Hong Kong adopts the 'territorial source principle' in charging tax. This means that generally income is only taxed if it arises in or is derived from Hong Kong through a trade, business or profession carried on in Hong Kong. However, there are a limited number of business receipts which would not otherwise be chargeable to tax in Hong Kong based on the above principle but are nonetheless deemed to be taxable in Hong Kong (e.g. certain royalties received by a non-resident for the use of copyright materials in Hong Kong or by a Hong Kong taxpayer).

Principal taxes

Hong Kong has a scheduler income tax system. Incomes of different nature are taxed separately. The main applicable taxes for doing business in Hong Kong are:

- **Profits tax** – tax on profits derived from Hong Kong from carrying on a trade, business or profession in Hong Kong.
- **Salaries tax** – tax on income derived from Hong Kong from an office, an employment or a pension.
- **Property tax** – tax on income derived from a real property in Hong Kong.

Apart from income tax, stamp duty is payable on chargeable instruments executing certain transactions. For transfer or sale of residential property, special stamp duty may be applicable.

Legislative framework

Under the Basic Law, Hong Kong is an autonomous Special Administrative Region of China and has a legal system that is separate from that of China. The adherence to the rule of law by the HKSAR Government ensures that an independent and effective legal system is being maintained in Hong Kong. The Hong Kong judiciary is renowned for its transparency and efficiency in upholding justice and safeguarding the rights and freedoms provided under the law.

The principal governing law for direct taxes is the Inland Revenue Ordinance, which is administered by the Commissioner of Inland Revenue. A dispute between taxpayers and the Commissioner on a question of law may be resolved through the court system.

Profits tax

Tax rates
The profits tax rates are 16.5% for corporations and 15% for unincorporated businesses for the year of assessment 2012-13, which are amongst the lowest in the region (e.g. compared with 25% in China and 17% in Singapore).

Key features
Below are the key features of the Hong Kong profits tax system.

Taxation of income:

- Trading receipts with a Hong Kong source are taxable.
- Capital receipts are not subject to tax.
- Dividends from local companies chargeable to tax are exempt whereas dividends from overseas companies are generally offshore in nature and not subject to tax.
- Certain exemptions are available, e.g. certain interest income derived by non-financial institutions; certain income of offshore or non-resident investment funds; exemptions for mutual funds/unit trusts/ qualifying debt instruments etc.
- Foreign source income is not taxed even if it is remitted to Hong Kong.

- Tax residence is generally irrelevant for profits tax purposes, except for the purpose of double taxation arrangement/agreements.

Deduction of expenses:

- Expenses that are revenue in nature and incurred in the production of assessable profits are deductible.

- Generous tax depreciation allowance or outright deduction for capital assets are available.

- Certain capital expenditure is deductible, e.g. qualified expenditure on research and development, cost of purchasing certain intellectual property rights etc.

Treatment of tax losses
There is no group tax relief in Hong Kong. Allowable tax losses can be carried forward indefinitely to offset against future assessable profits but cannot be carried backward.

Taxation of payments to non-residents
Hong Kong does not impose any withholding tax on dividends or interest paid to non-residents. Certain royalties received by non-resident corporations are subject to profits tax at 4.95% (i.e. a deemed profit rate of 30% of the sum received at the profits tax rate of 16.5%) or 16.5% (i.e. 100% of the sum received is deemed taxable where the amount is received from an associated corporation and where the intellectual property was once owned by a person carrying on business in Hong Kong). A lower withholding rate may be available when the recipient is a resident of a jurisdiction with which Hong Kong has a tax treaty.

Transfer pricing
For transactions between a Hong Kong company and a closely connected non-resident, where the transactions result in no profit or less than the ordinary profit for the Hong Kong company, the non-resident is deemed to carry on business in Hong Kong through the Hong Kong company. Other than the specific transfer pricing rule that deals with transactions between Hong Kong companies and non-residents, the general anti-avoidance provisions may also be used by the tax authority to challenge non-arm's length transactions. The tax authority issued a Departmental Interpretation and Practice Note in December 2009 to provide guidelines on transfer pricing methodologies and related issues. In general, the Organisation for Economic Co-operation and Development (OECD) transfer pricing guidelines will be applied by the tax authority. Taxpayers with cross-border related-party transactions may apply for an advance pricing arrangement in respect of their transactions with associated companies who are resident in a jurisdiction with which Hong Kong has a tax treaty.

Salaries tax

Tax rates
For the year of assessment 2012-13, the progressive rates range from 2% to 17% (with a marginal tax band of HK$40,000) and the standard rate is 15%.

Key features
Below are the key features of the Hong Kong salaries tax system:

Taxation of income:

- Income arising in or derived from Hong Kong from an office, an employment or a pension is subject to salaries tax. This includes but is not limited to:

  – *salaries and wages*
  – *leave pay*
  – *fees*
  – *commissions*
  – *bonuses*
  – *gratuities*
  – *perquisites*
  – *pensions*
  – *the rental value of a place of residence provided by an employer*
  – *income from vesting of share awards*
  – *gains derived from any employee share options are also taxable when the option is exercised, assigned or released.*

- For non-Hong Kong employments, only income derived from services rendered in Hong Kong is taxable.

Facts at a glance

- Hong Kong adopts the 'territorial source principle' in charging tax, i.e. only income arising in or derived from Hong Kong is taxable.
- Businesses are subject to profits tax at 16.5% or 15% on trading profits sourced in Hong Kong.
- Individuals are subject to salaries tax at either progressive rates (ranging from 2% to 17%) or standard rate of 15% on Hong Kong sourced income from an office, an employment or a pension.
- No tax on capital gains and dividends.
- No turnover tax.
- No withholding tax on payments of interest or dividends to non-residents; certain royalties received by non-residents are subject to tax at 4.95% in general.
- Other applicable taxes include property tax and stamp duty.

- Residence, domicile or citizenship is generally irrelevant except for the purpose of double taxation arrangement/agreements.

Deductions and allowances:

- Various concessionary deductions are available: e.g. approved charitable donations, home loan interest, self-education expenses, contributions to recognised retirement schemes etc.
- Various personal allowances such as basic allowance, child allowance and dependent parent allowance are also available when progressive tax rates apply.

Tax thresholds

There is a 60-day income exemption in Hong Kong. Individuals who 'visit' Hong Kong for not more than 60 days in a year of assessment may not be liable to salaries tax. Nevertheless, tax reporting may still be required depending on the employment arrangement. With Hong Kong's recent expansion of the treaty network, the threshold as defined in the respective treaties is more widely used to provide additional protection from being liable to salaries tax. Individuals who are eligible for treaty protection can generally be exempt from salaries tax if the following conditions are met:

- the individual's cumulative stay in Hong Kong does not exceed 183 days in a base period (this base period varies from one treaty to another);
- the remuneration is not paid by, or on behalf of, a resident entity in Hong Kong; and
- the remuneration is not borne by a permanent establishment in Hong Kong.

In order to enjoy treaty protection, the individual is required to file an individual tax return and make the claim in the return.

Structuring of remuneration package

Employees will often receive allowances and benefits in addition to their regular salary, bonuses and commissions.

It is essential that the relevant tax issues be considered prior to the determination of the remuneration package. Tax advantages may be provided without increasing the overall cost of the employer. The following are some examples of components which, if properly structured, would be exempt from salaries tax or taxed preferentially:

- Accommodation provided by the employer.
- Company car.
- Relocation expenses.

Withholding tax

There is no withholding on wages, with the exception that an employer is under an obligation to withhold any payment to an employee who is about to leave Hong Kong other than on a normal business trip.

Property tax

Property tax is levied on the owner of any land or buildings in Hong Kong at the standard rate of 15% (for the year of assessment 2012-13) on income derived from the right to use such land or buildings (i.e. rental income).

If income from property chargeable to property tax is included in a corporation's profits for profits tax purposes, the amount of property tax paid is set-off against the profits tax assessed. A corporation which pays profits tax on the profits derived from a property can alternatively claim exemption from property tax.

Property tax is not assessed when the property is used as a residence by the owner because there is no consideration for the use of the property.

Stamp duty

The following table summarises the stamp duty rates for three major types of chargeable instruments for year of assessment 2012-13.

Relief is provided for the transfer of shares or properties between group companies if certain conditions are satisfied.

There is a Special Stamp Duty ('SSD') on resale of residential property which was acquired on or after 20 November 2010 and resold within 24 months from the date of acquisition. The SSD will be imposed on top of the ad valorem stamp duty currently payable on conveyance on the sale of immovable property as shown in the table below, with a few certain exemptions available. The SSD rates range from 5% to 15% with higher rates for shorter holding periods. The SSD payable will be calculated based on the stated consideration or the market value (whichever is higher) of the resold property at the applicable duty rate. The seller and buyer are jointly and severally liable for paying the SSD.

Capital gains tax

There is no capital gains tax in Hong Kong.

Turnover tax

Hong Kong does not impose any turnover tax.

Three major types of stamp duty rates

Chargeable instrument	Duty rate	Person(s) liable
Agreement for transfer of Hong Kong stock	0.2% of the value of the stock	Half by the transferor and half by the transferee
Conveyance on sale of immovable property	HK$100 – 4.25% of the consideration of the property (see Note 1)	All parties executing the transaction
Lease of immovable property	0.25% – 1% of the annual rental (see Note 2)	All parties executing the transaction

Notes:
1. Rate varies with the property consideration, with higher rate for higher property value and marginal relief upon entry into each higher rate band.
2. Rate varies with the term of the lease with higher rate for longer lease period.

Administration of the tax system

The tax year runs from 1 April of a year to 31 March of the following year.

Taxable profits are computed based on the accounting profits of the financial year ending within the tax year with appropriate adjustments for tax purposes. Normally, the profits tax return is issued on the first working day in April following the tax year. Companies are required to file the tax return within a prescribed period. Electronic filing via the eTAX system is available to small corporations if certain conditions are satisfied.

Withholding tax rates on various types of passive income			
	Dividends	**Interest**	**Royalties**
HK domestic non-treaty rate for non-resident corporations	0%	0%	4.95%
HK domestic non-treaty rate for non-resident individuals	0%	0%	4.5%
Austria	0/10%	Nil	3%
Belgium	0/5/15%	0/10%	5%
Brunei	Nil	0/5/10%	5%
Czech Republic	5%	0%	10%
France	10%	0/10%	10%
Hungary	5/10%	0/5%	5%
Indonesia	5/10%	0/10%	5%
Ireland	0%	0/10%	3%
Japan	5/10%	10%	5%
Jersey	Nil	Nil	4%
Kuwait	0/5%	0/5%	5%
Liechtenstein	Nil	Nil	3%
Luxembourg	0/10%	Nil	3%
Mainland China	5/10%	0/7%	7%
Malaysia	5/10%	0/10%	8%
Malta	Nil	Nil	3%
The Netherlands	0/10%	Nil	3%
New Zealand	0/5/15%	0/10%	5%
Portugal	5/10%	10%	5%
Spain	0/10%	0/5%	5%
Switzerland	0/10%	0%	3%
Thailand	10%	10/15%	5/10/15%
The UK	0/15%	0%	3%
Vietnam	10%	0%/10%	7%/10%

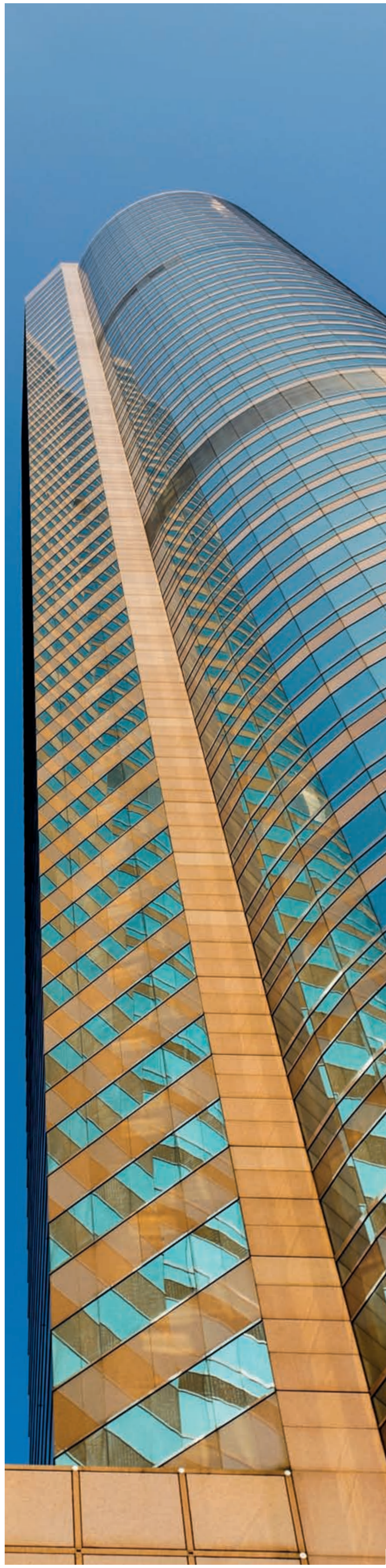
Note: The withholding rates under the domestic law would apply if they are lower than the rates specified in the arrangement/agreements.

Individual taxpayers will receive their tax returns in May. The individual tax return has to be filed within a month from the date of issue in general. Electronic filing via the eTAX system is available to individual taxpayers whose case is not complicated. Notice of assessment will be issued after the tax return has been examined by the tax authority. The dates of payment of tax are specified in the assessment notice. A system of provisional tax payments applies whereby estimated tax payments are made during the current tax year. The provisional tax payable is normally estimated based on the previous year's tax liability. The final tax liability for a tax year is subsequently determined after lodgement of the return and the provisional tax paid will then be deducted from the final tax payable.

Tax treaty network

As of mid-May 2012, Hong Kong entered into 24 comprehensive double tax arrangement/agreements with the following countries respectively: Austria, Belgium, Brunei, the Czech Republic, France, Hungary, Indonesia, Ireland, Japan, Jersey, Kuwait, Liechtenstein, Luxembourg, mainland China, Malaysia, Malta, the Netherlands, New Zealand, Portugal, Spain, Switzerland, Thailand, the United Kingdom and Vietnam. As of mid-May 2012, the agreements with Jersey, Kuwait, Malaysia, Malta, Portugal and Switzerland have not yet entered into force pending the completion of the ratification procedures of the governments concerned. The table on the left summarises the withholding tax rates on various passive incomes specified in the arrangement/agreements concluded by Hong Kong so far.

In addition, Hong Kong has entered into agreements for relief from double taxation with respect to international air traffic and international operation of ships with numerous countries.



Taxation in mainland China

The standard corporate income tax rate for tax resident enterprises in mainland China is 25% but various tax incentives are available to businesses engaged in certain industries.

China tax regime

Principal taxes
The main applicable taxes when doing business in China are as follows:

1. Taxes on income:
   a. Corporate income tax (CIT)
   b. Individual income tax (IIT)

2. Taxes on transactions – turnover tax system:
   a. Value-added tax (VAT)
   b. Business tax (BT)
   c. Consumption tax (CT)

3. Other taxes:
   a. Customs duties
   b. Stamp tax
   c. Vehicle and vessel tax
   d. Motor vehicle acquisition tax
   e. Deed tax
   f. Land appreciation tax
   g. Real estate tax
   h. Urban and township land-use tax
   i. Resources tax
   j. Urban Construction and Maintenance Tax
   k. Education Surcharge
   l. Local Education Surcharge
   m. Vessel tonnage tax
   n. Arable land occupation tax
   o. Other surtaxes and levies

Corporate income tax (CIT) law

Key messages

- Tax resident enterprises, which include enterprises incorporated in China and foreign enterprises whose effective management is located in China, are liable to CIT on their worldwide income.
- Accelerated depreciation is acceptable under certain circumstances.
- Amortisation of intangible assets is allowed.
- In principle, the accrual method of accounting is required.
- Income tax is levied at a flat rate of 25%.
- Dividends paid between qualified tax resident enterprises are exempt from CIT. However, non-tax resident enterprises are subject to a 10% withholding CIT (unless reduced under a tax treaty) on dividend income derived from China.
- Foreign tax credits are available.
- Qualified technology related enterprises are eligible for a reduced tax rate of 15% or 10% upon approval. Other forms of tax incentives – tax holiday, reduction of revenue, investment tax credit, etc – are also available for enterprises that are engaged in encouraged industries or which invest in research and development and specific equipment.
- Arm's length prices must be used for transactions conducted between related parties.

Corporate income tax system

Residence concept
Enterprises incorporated in China are automatically tax resident enterprises. A foreign enterprise with its effective management located in China is also regarded as a tax resident enterprise. The effective management refers to the place where the overall management and control over the business and production, personnel, accounting, properties etc, of an enterprise is, in substance, exercised. Tax resident enterprises are subject to CIT on worldwide income.

A non-tax resident enterprise, which has an establishment or place of business in China, is subject to CIT on the income derived by such establishment or place of business. Examples of such establishment or place of business include representative offices, factories, farms, places where natural resources are exploited; places where labour services are provided; places where contractor projects (e.g. construction, installation, assembly, repair and exploration) are undertaken.

For a non-tax resident enterprise that has no establishment or place of business in China, or that has an establishment or place of business in China but the income derived from there is not effectively connected with such establishment or place of business, is subject to withholding CIT on China source income (generally includes passive income, such as, dividends, interest, royalties, rental income, capital gains).

To avoid double taxation of foreign sourced income, a foreign tax credit is allowed for income taxes paid to other countries on foreign-sourced income.

Tax Incentives

Reduced tax rate
The following enterprises are eligible for the reduced CIT rate of 15% upon approval:
a. Qualified new/high tech enterprises;
b. Qualified integrated circuits ('IC') production enterprises;
c. Qualified technology advanced service enterprises.

Qualified key software production enterprises are eligible for a reduced CIT rate of 10%.

Tax reduction and exemption
Enterprises carrying out the following projects are eligible for a certain period of tax holidays upon approval;
a. Agriculture, forestry, animal-husbandry and fishery projects;
b. Specified basic infrastructure projects;
c. Environment protection projects and energy/water conservation projects;
d. Qualified new/high tech enterprises established in Shenzhen, Zhuhai, Shantou, Xiamen, Hainan and Pudong New Area of Shanghai established after 1 January 2008;
e. Software production enterprises;
f. IC design enterprises;
g. Qualified IC production enterprises;
h. Qualified energy-saving service enterprises;
i. Encouraged enterprises in underprivileged areas of Xinjiang.

Other forms of incentives
Other forms of tax incentives – reduction of revenue, investment tax credit, etc. – are also available for enterprises that are engaged in encouraged industries or which invest in research and development and specific equipment.

Gross income

Inter-company transactions
In principle, the CIT law requires an enterprise to conduct business transactions with its related parties in accordance with the arm's length principle. If a related party transaction is not conducted at arm's length and there is a reduction of gross income or taxable income, the Chinese tax authorities are authorised to make the appropriate tax adjustment.

Facts at a glance

- Starting from 1 January 2008, a unified corporate income tax (CIT) system is applicable to foreign investment enterprises and foreign corporations, as well as domestic enterprises.
- Tax resident enterprises in China are taxed on their worldwide income. Non-tax resident enterprises are taxed on China sourced income.
- CIT is at a flat rate of 25%.
- Individuals are subject to China's individual income tax (IIT) law. Individuals domiciled in China are subject to IIT on their worldwide income.
- Foreign individuals who are not domiciled in China and have not resided in China for more than five years may reduce their IIT liabilities on employment income under certain conditions. Employment income is subject to the progressive rates from 3% to 45%. Individuals carrying out sole-proprietary business are subject to the progressive rates from 5% to 35%.
- Double taxation relief is offered through credit, exemption or reduction provided under national statutes and tax treaties.

Capital gains, interest, royalties and dividends
Capital gains, interest and royalty income derived by a tax resident enterprise are taxable as ordinary income. Capital gains refers to the gains from the disposition of property, including residential property, buildings, structures and attached facilities located in China, and from the assignment of land use rights and the transfer of equity investments. For any gain derived from the transfer of land use rights, buildings and premises and related facilities attached thereto, a land appreciation tax is also levied.

Dividends paid between qualified tax resident enterprises are CIT exempt under the CIT law.

Service fees
Service fees generated from consultation, management, training and other labour services by a tax resident enterprise are taxable as part of worldwide income, irrespective of the locality in which the services are performed.

Exchange gains and losses
Exchange gains and losses incurred during business transactions and year-end translation in respect of assets and liabilities denominated in foreign currencies should generally be accounted for in the current year.

Donation and debt forgiveness
Unless otherwise prescribed in the tax regulations, tax resident enterprises should include donations received and releases from debt as their taxable income.

Non-taxable income
Fiscal appropriation, governmental administration charges and governmental funds that are collected and administered as treasury management of the state are non-taxable income under the CIT law.

Tax-exempt income
Tax-exempt income includes: interest on state treasury bonds; dividends paid between qualifying tax resident enterprises; dividends derived by a non-tax resident enterprise that has an establishment or place of business in China from a tax resident enterprise (the dividends are effectively connected with the establishment or place of business); and income derived by qualifying non-profit-seeking organisations.

Deductions

Business expenses
In principle, unless specifically excluded under the CIT law and other tax regulations, reasonable business expenditures including costs, expenses, taxes and losses, that are actually incurred by a tax resident enterprise and relevant to the generation of income, are deductible.

Depreciation
The straight-line method of depreciation has to be followed and there is a minimum depreciation period for different types of fixed assets. Certain fixed assets, for example, fixed assets replacement due to advancement of technology or fixed assets that are subject to constant vibration or severe corrosion, may be depreciated over a shorter period or using accelerated depreciation methods.

Interest
Interest on loans is generally deductible. On borrowings from non-financial institutions by a non-financial institution, the deductible interest expense cannot exceed the commercial interest rate. However, the deduction of interest paid to related parties is subject to the thin capitalisation rule under the CIT Law. The thin capitalisation ratio for the financial industry is 5:1 and for other industries is 2:1.

Staff welfare expenses

Expenses incurred for basic social security contributions, supplementary pension insurance and supplementary medical insurance for local Chinese staff are deductible, subject to caps stipulated by the government.

Other staff welfare expenditure is deductible subject to a cap of 14% of the total salaries expenses of an enterprise.

Insurance premiums

Premiums paid for commercial insurance for investors or employees are generally not deductible with a few exceptions.

Payments to affiliates

Management fees of a stewardship nature are not deductible. However, service fees paid for genuine services provided by affiliates in China or overseas, and charged at arm's length, may be allowed for deduction. Other payments to affiliates, such as royalties, are also tax-deductible provided that the charges are at arm's length.

Other deductions

- **Business entertainment expenses**
  Only 60% of actual incurred business entertainment expenses are deductible. In addition, the total amount is capped at 0.5% of the total sales (business) revenue of the given tax year.
- **Bad or doubtful debts**
  Enterprises other than financial institutions are not allowed to deduct bad debt provisions for CIT purpose. Financial institutions may deduct bad debt provision subject to a cap for CIT purposes. Bad debt losses are deductible only when the loss is actually incurred and approved by the in-charge tax bureau.
- **Amortisation of intangible assets**
  The straight-line method is allowed with a minimum amortisation period of not less than 10 years or pursuant to the useful life agreed in the contracts.
- **Advertising and promotional expenses**
  The deduction is limited to 15% of the annual sales revenue. Excess portion is allowed to be carried forward and deducted in future years.
- **Research and development (R&D)**
  A tax resident enterprise that incurs qualified R&D expenses for the development of new techniques, new products and new craftsmanship is entitled to an extra 50% deduction of the R&D spending.
- **Donations**
  Donations to qualified charitable institutions are deductible up to 12% of the annual profit.

- **Pre-operating expenses**
  They can be deducted for CIT purpose at the start-up of the business.

Non-deductible items

The CIT law states that the items listed below are non-deductible in calculating the taxable income of a tax resident enterprise:

1. Payment of equity investment returns to investors such as dividends
2. CIT payments
3. Tax surcharges
4. Penalties, fines and losses due to the confiscation of property
5. Donations to institutions other than qualified charitable institutions
6. Sponsorship expenditures
7. Provisions that have not been verified
8. Other expenditure that is irrelevant to the generation of income.

Losses

Tax losses
Tax losses incurred by a tax resident enterprise may be carried forward and deducted from the succeeding five years' taxable income. Tax carry-back is not allowed.

Asset losses
Deductible if approved by the in-charge tax bureau. Examples include loss on equity and debt investment, loss on bad debt, extraordinary losses etc. However, asset loss incurred during ordinary business operation is deductible and approval is not needed.

Withholding CIT

Non-tax resident enterprises that do not have an establishment or place of business in China, or those that have a permanent establishment or place of business but earn China sourced income such as dividends, interest, rent and royalties, that are not effectively connected with that establishment or place of business, will be subject to withholding CIT at a concessionary rate of 10% (though the statutory standard rate is 20%) on such income sourced in China unless reduced under a tax treaty. Nevertheless, dividends distributed by a foreign investment enterprise out of its pre-2008 profit are still exempted from withholding tax.

Tax computation

Taxable income
Taxable income is defined as the amount from the gross income in a tax year after deduction of non-taxable income, tax exempt income, various deductions and allowable losses brought forward from previous years.

Taxable income in foreign currency should be converted into RMB to come up with the tax payable.

Tax rates
The resident enterprises are subject to the standard CIT rate of 25% or a reduced rate provided if the specified conditions are satisfied and approved by the tax authorities. Non-tax resident enterprises which derive income effectively connected with their establishments or places of business in China are subject to the CIT rate of 25%.

Foreign tax credits
A tax resident enterprise that generates foreign source income may deduct the foreign income tax paid from the amount of CIT payable. However, the deductible amount may not exceed the amount of CIT otherwise payable in respect of the foreign source income in China.

If the foreign tax paid exceeds the limit, the unrelieved balance of the foreign tax paid may be offset against the tax payable in subsequent years, up to a maximum of five years. An enterprise applying for a foreign tax credit must submit the original tax receipts to support its claim for a foreign tax credit.

Consolidation
A tax resident enterprise should make combined CIT filings for its branches. Except for rules otherwise prescribed by the State Council, affiliated companies are not permitted to file consolidated returns on a group basis.

Tax reporting

Tax returns
The tax year for enterprises is the calendar year. Tax resident enterprises are required to file their annual income tax returns and annual financial statements within five months after the end of a tax year, together with an audit report issued by a Chinese-registered CPA firm. Generally, non-tax resident enterprises with its establishment or place of business in China must perform the annual CIT filing with required documents within five months after the end of the calendar year. There are exceptions that non-tax resident enterprise may not need to perform the annual CIT filings.

There is a late payment surcharge of 0.05% of the unpaid tax balance for each day the income tax is in arrears. If the taxpayer fails to file a return or pay the tax due, an additional fine may be assessed.

Being withholding agents, the payers who make payments of dividends, interest, rent, royalties or other income to non-tax resident enterprises are required to file a withholding tax return, withhold the proper tax and remit the tax to the tax authorities once payments to non-tax resident enterprises are made or accrued as deductible expenses in the account of the payers for CIT purposes.

Assessments
Enterprises are required to make provisional assessments and file CIT returns on a monthly or quarterly basis. The returns are generally prepared on a self-assessment basis and the provisional payments are reconciled after the year-end in an annual return for final tax settlement. Any tax discrepancy must be paid within five months after the year-end and any tax overpayment may be refunded upon approval by tax authorities.

Turnover taxes

Key messages
- Nearly all transactions in China are subject to a turnover tax, either value added tax (VAT) or business tax (BT). Certain categories of consumable goods are also subject to consumption tax (CT).
- The standard rate of VAT is 17%; reduced rates and exemptions are available.
- BT rates range from 3% to 20%.

Value-added tax (VAT)

- Scope
  The sale of taxable goods and the provision of labour services in relation to the processing of goods and of repair and replacement services within China are subject to VAT. 'Taxable goods' refers to tangible goods as well as certain utilities such as electricity, thermal power and gas, but the term excludes real estate properties. VAT is also levied on the import of taxable goods into China unless the imports are specifically exempt under special rules.

- Registration
  Enterprises that make sales taxable for VAT purposes in China should voluntarily register for VAT with the local tax authority. VAT payers are generally classified into two categories: general VAT payer and small-scale VAT payer.

- Rates
  General VAT payers are subject to the standard rate of 17% which applies to most taxable goods and services and the lower rate of 13% which applies to certain goods. Small-scale VAT payers are levied at the rate of 3%. The sale of certain goods is exempted from VAT.

- Basis of taxation
  VAT is levied and collected on the basis of the value added to the taxable goods or services at each stage of a production chain, i.e. from the acquisition of raw materials by producers to the purchase of finished goods or services by consumers. At each stage, VAT on sales (output tax) is collected by the seller from the purchaser.

With the support of a valid VAT invoice, the general VAT payer can generally deduct the VAT that has been paid on the purchase of goods (including fixed assets) that are used for the taxable sales (input tax) and account for the difference to the authorities.

- VAT on exports
  Exporters of goods from China may be entitled to a refund of input VAT incurred on the exported goods. As the refund rates range from 0% to 17%, exporters may not be able to enjoy the full refund of input VAT incurred and suffer a certain degree of VAT costs on exports.

Business tax (BT)

- Scope
  BT applies to the provision of services (excluding processing services and repair and replacement services, which are taxed under the VAT regime). It also applies to the transfer of intangible assets such as goodwill, patents and the sale of real estate properties in China. BT and VAT are mutually exclusive.

- Rates
  BT rates are 3% or 5%, except for the leisure and entertainment industry which may attract a rate of up to 20%. It is not recoverable but may be deductible for income tax purpose.

- Registration
  Enterprises that provide services or sell intangible assets or properties within the scope of BT should voluntarily register for business tax with the local tax authority.

- Basis of taxation
  Unlike VAT, business tax is not a creditable tax and is generally levied on the gross income. Business taxpayers in certain specified industries are allowed to compute BT liabilities on the net income.

Pilot Programme in Shanghai

In order to mitigate the multiple taxation issue associated with goods and services, the State Council resolved in 2011 to introduce a Pilot Programme in the city of Shanghai to expand the scope of VAT to cover selected industries that were originally subject to BT. Under the Pilot Programme, enterprises providing the selected services in Shanghai are subject to VAT instead of business tax from 1 January 2012.

Consumption tax (CT)

CT is imposed on 14 categories of goods, including cigarettes, alcoholic beverages, certain luxury and environmental unfriendly items. It is not recoverable but is deductible as an expense for income tax purposes. CT is computed based on the sales amount and/or the sales volume depending on the goods concerned.

Individual income tax (IIT) on employment income

The extent to which a foreign individual is subject to IIT depends on his domicile, the length of his stay in China, the source of his income, the entity which ultimately bears the salary costs and his connection with any China establishment. An individual who is domiciled in China is subject to IIT on his worldwide income. In general, a foreign individual is only liable to IIT on his China source income (whether it is paid inside or outside of China) – rather than on his worldwide income – unless he resides in China for a full year after having resided in China for five consecutive full years.

Under the current IIT laws and regulations, a foreign individual would be exempt from IIT if the Chinese tax authorities are satisfied that all of the following three conditions are satisfied:

i. The individual is present in China for a period or periods not exceeding 90 days in aggregate during the calendar year concerned (for a tax treaty resident, this 90-day threshold is extended to 183 days within a base period as specified in an applicable DTA);
ii. The remuneration is paid by, or on behalf of, an employer who is not a resident of China; and
iii. The remuneration is not borne by a permanent establishment or a fixed base which the employer has in China.

With effect from 1 October 2009, an employee or his withholding agent (e.g. his employer) is required to perform the 'record-filing' with the in-charge tax bureau to secure the above 183-day exemption on his employment income.

Apart from employment income, IIT is also levied on other types of income. For example, director's fees and consultancy fees are income that are also assessable under IIT, and the IIT treatment of which would require a detailed review of the nature of income and the work performed by the individual.

China adopts a tax withholding system whereby the payer (e.g. the employer) is regarded as the tax withholding agent and is required to file monthly IIT withholding returns, withhold and remit the IIT due to the Chinese tax authorities, normally within fifteen days after the end of the month. Where the salary payment is made outside of China, the regulations require that the Chinese affiliated company (e.g., the WFOEs) or the Chinese establishment for the offshore company bears the tax withholding obligations.

Audit and accountancy

Accounting requirements

Hong Kong incorporated companies are required to prepare financial statements that give a true and fair view. Such financial statements must be prepared and presented in accordance with Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA), which are fully aligned with International Financial Reporting Standards. HKFRSs comprise all Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Hong Kong Interpretations approved by the Council of the HKICPA.

Under the Hong Kong Companies Ordinance, the directors of every company must lay before the shareholders in the annual general meeting audited financial statements. The first accounts must cover the period since the incorporation of the company. Thereafter, the accounts must cover the period since the preceding accounts and must be made up to a date following not more than six months or, in the cases of a private company and a company limited by guarantee, not more than nine months before the date of the meeting. In the case of a company having subsidiaries at the end of its financial year, group accounts (consolidated financial statements) dealing with the state of affairs and results of the company and its subsidiaries must be laid before the shareholders, unless certain conditions for exemption under the Companies Ordinance and HKFRSs are met.

The Companies Ordinance also sets forth the disclosure requirements relating to the balance sheet and the profit and loss account (income statement) set out in the financial statements for a company.

Financial statements shall be presented at least annually. Except for the first accounting period after incorporation, the accounting period should normally cover one year. The accounting year end is not fixed by statute and can be determined by the company.

Requirements on statutory audit

The Companies Ordinance specifies that every company incorporated in Hong Kong must appoint one or more independent auditors. An auditor must be a member of the HKICPA and hold a practicing certificate issued by the Institute.

Under the Companies Ordinance the auditor is required to report to the shareholders on the financial statements under Hong Kong Standards on Auditing issued by HKICPA and laid before the company in the annual general meeting during their tenure of office.

The first auditors of a company may be appointed, by the directors at any time before the first annual general meeting, to hold office until the conclusion of the meeting. Subsequently, except for appointments to fill casual vacancies, auditors are appointed by the shareholders in the annual general meeting to hold office until the next annual general meeting.

The auditors' report must be read before the company in the annual general meeting and must state whether, in the opinion of the auditors, the accounts show a true and fair view and whether they have been properly prepared in accordance with the relevant provisions and standards.

A Hong Kong branch of a foreign corporation is not subject to statutory audit requirement under the Companies Ordinance. However, if the branch is doing business in Hong Kong, it is required to file a profits tax return annually, and the Inland Revenue Department may require audited accounts of the foreign corporation to support its profits tax return.

Human Resources and Employment Law

Key employment law considerations

Employment in Hong Kong is mainly governed by the Employment Ordinance, Mandatory Provident Fund ('MPF') Schemes Ordinance, Employees' Compensation Ordinance, Occupational Safety and Health Ordinance and four ordinances implemented by the Equal Opportunities Commission.

The Employment Ordinance governs employee rights, such as the payment of wages, termination of employment contracts, sickness allowance, maternity protection, rest days, paid annual leave, protection against anti-union discrimination and long-service payments or severance payments. The Employment Ordinance is applicable to all employees except for certain very limited categories of persons as defined under the Ordinance.

Employees who have been employed continuously by the same employer for four weeks or more, with at least 18 hours worked in each week, are regarded as being employed under a continuous contract. Such employees are further entitled to benefits such as rest days, paid annual leave, sickness allowance, severance payment and long-service payment. Employees who are not employed under a continuous contract are not entitled to the above benefits but are still entitled to the rest of the basic protection under the Employment Ordinance such as payment of wages, restrictions on wages deductions, granting of statutory holidays, etc.

Contract requirements

A contract of employment is an agreement on the employment conditions made between an employer and an employee. The agreement can be made orally or in writing. Employers and employees are free to negotiate and agree on the terms and conditions of employment provided that they do not violate the provisions of the Employment Ordinance. Verbal or written contracts must include: wages, wage period, length of notice required to terminate the contract and if the employee is entitled to an end of year payment, the end of year payment or the proportion thereof and the payment period.

Restriction on local hires

The Employment of Children Regulations prohibits the employment of children aged under 15 in all industrial undertakings. Subject to certain protective restrictions, children aged 13 and 14 who are attending school may take up part-time employment in the non-industrial sectors.

The Employment of Young Persons (Industry) Regulations govern the employment conditions of young persons aged 15 to 17 in industrial undertakings. These young persons are not allowed to work more than eight hours a day, 48 hours a week and 6 days per week. Overtime, night work, rest days and work on statutory holidays are prohibited. The maximum duration of continuous work for them is 5 hours and must be followed by at least half an hour of meal or rest.

Minimum wage

The average hourly wage of employee in respect of any wage period should not be less than the statutory minimum wage rate of HK $28 per hour. This is applicable to all employees except for persons to whom the Employment Ordinance does not apply (e.g. student interns).

Unless specified, wages include all remuneration, earnings and allowances. The calculation of minimum wage excludes the hours not worked (such as rest day pay, holiday pay, annual leave pay, maternity leave pay, sickness allowance, etc).

Working hours

Under Hong Kong's employment legislation, there is no provision governing the maximum number of working hours for an employee. There have been discussions within the Legislative Council and in the community on the necessity to draw up legislation to govern the maximum number of working hours in Hong Kong with no decision yet made.

Holiday and leave

1. **Rest Day**
Employees employed under a continuous contract are entitled to not less than one rest day in every period of seven days.

2. **Statutory Holidays**
All employees, irrespective of his length of service or employment nature (continuous or non-continuous contract), are entitled to 12 days of statutory holidays.

3. **Public Holidays**
In addition, the Government announces the public holidays annually to be enjoyed by civil servants. It is a common practice that 'blue collar' employees (e.g. production workers) enjoy 12 statutory holidays while 'white collar' employees (e.g. office staff) enjoy the 17 days of public holidays which include the 12 days of statutory holidays.

4. **Paid Annual Leave**
Employees are entitled to annual leave with pay after having been employed under a continuous contract for every 12 months and the entitlement increases progressively from seven days to a maximum of 14 days according to his/her length of service.

5. **Sick Leave**
Employees can accumulate paid sickness days after having been employed under a continuous contract. Paid sickness days can be accumulated up to a maximum of 120 days. Employees are entitled to sickness allowance if:

- the sick leave taken is not less than four consecutive days;
- the sick leave is supported by an appropriate medical certificate; and
- the employee has accumulated sufficient number of paid sickness days.

6. **Maternity Leave**
A female employee employed under a continuous contract immediately before the commencement of her maternity leave is entitled to a continuous period of 10 weeks maternity leave.

An employee is eligible for maternity leave pay if she has been employed under a continuous contract for not less than 40 weeks immediately before the commencement of scheduled maternity leave.

Recruitment of staff

Since Hong Kong is in the transition period to implement 3-3-4 education system (3 years middle school, 3 years high school and 4 years university), there are graduates from 2 classes (the new system's graduating class, as well as the old system's graduating class) joining the labour market this year. As a result, there is increasingly high competition for positions. The unemployment rate in Q1 2012 stood at 3.4%, and will likely rise further. On the other hand, the stability of the global economy remains uncertain. Talent retention and the competition for good candidates become crucially important for businesses looking to grow, and effectively manage their people in a time of such uncertainty.

Common recruitment channels used by employers from different sectors and industries are:

- Employment websites;
- Newspaper and magazine advertisement;
- Private employment agencies; and
- Extensive recruitment network provided by the Labour Department.

Non-Hong Kong residents must obtain an employment visa in order to work in Hong Kong.

Immigration

Immigration arrangements for non-local graduates

Non-Hong Kong residents who have obtained a degree or higher qualification in a full-time and locally accredited programme in Hong Kong ('non-local graduates') may apply to stay or return and work in Hong Kong under the 'Immigration Arrangements for Non-local Graduates'.

General employment policy

Non-Hong Kong residents who are not non-local graduates but possess special skills, knowledge or experience of value to and not readily available in Hong Kong may apply to come to work under the General Employment Policy ('GEP').

The Hong Kong Immigration Department will consider the following in approving an employment visa:

- whether the business being undertaken is beneficial to the economy, industry and trade of Hong Kong;
- whether the employment of the applicant is essential to the business; and
- whether the position can easily be filled by a local individual.

Admission scheme for Mainland China talents and professionals

Chinese residents of the Mainland China who are not non-local graduates but possess special skills, knowledge or experience of value to and not readily available in HK may apply to come to work under the Admission Scheme for Mainland Talents and Professionals.

Working conditions

Role of unions/collective bargaining etc

The Basic Law guarantees that Hong Kong residents have freedom of association and the freedom to form and join trade unions. The Employment Ordinance provides that every employee has the rights:

- to be a member/an officer of a trade union registered under the Trade Unions Ordinance;
- to take part in activities of the trade union, to which the employee is a member/an officer, outside working hours or during working hours with the consent of the employer; and
- to associate with others in forming or applying for the registration of a trade union.

Termination of employment

Upon termination of employment, the employee will be entitled to the termination payment within seven days of the termination date. Such payment includes:

- outstanding wages;
- wages in lieu of notice, if any;
- payment in lieu of any untaken annual leave accumulated up to the termination date;
- any outstanding sum of end of year payment;
- long-service payment (for terminating employees who have been employed not less than 5 years under a continuous contract and not being terminated due to serious misconduct or redundancy) or severance payment (if applicable); and
- other payments under the employment contract, such as, gratuity, provident fund.

If the terminated employee is dismissed by reason of redundancy, he/she will be entitled to severance payment if he/she has been employed not less than 24 months under a continuous contract. An employer can offset severance payment against the accrued benefits derived from contributions the employer has made to the employee in the Mandatory Provident Fund scheme.

Employee benefits

The Employment Ordinance sets out minimum entitlements for employees, such as statutory holidays, sick and maternity leave, severance and long-service payments. It is up to the discretion of employers to provide additional benefits, such as overtime payment, medical plans and life insurance.

- **Mandatory Provident Fund ('MPF')**
All employers in HK are required to make a mandatory contribution of 5% of employees' relevant income (i.e. basic salary and bonus), up to a maximum of HK$1,250 per month to the Mandatory Provident Fund (MPF) scheme and employees are required to make a matching contribution. However, effective from 1 November 2011, employees whose income is below HK$6,500 (previously HK$5,000) per month are exempted from making the matched contribution to the MPF.

- **Employee Compensation Insurance**
The Employees' Compensation Ordinance establishes a no-fault, non-contributory employee compensation system under which individual employers are liable to pay compensation for work-related injuries or fatalities. The Ordinance requires all employers to possess valid insurance policies to cover their liabilities under the ordinance and common law.

The Employee Compensation Insurance premium is determined based on employees' annual remuneration, nature of work, workplace location, etc.

Trade

General trade and commercial regulations

The Hong Kong Government has adopted a policy of minimum intervention towards the regulation of the territory's business and industry, and this policy has contributed to the territory's attractiveness to foreign investors.

Every business in Hong Kong, whether carried on by an individual, a partnership or a corporation and whether locally or foreign-owned, must be registered under the Business Registration Ordinance, which is administered by the Inland Revenue Department. There are no other significant regulations or restrictions imposed on conducting business in Hong Kong, except in situations where there is a genuine need to fulfil obligations undertaken by Hong Kong to its trading partners, or to meet public health, safety or internal security needs. In a few specially regulated industries such as the banking, securities, insurance and telecommunication industries, special legislations and licensing requirements apply.

Restrictions on foreign investment

In general, no restriction applying specially to foreign investors is imposed and wholly foreign-owned companies are allowed. The only exception is the restriction on foreign ownership of Hong Kong's licensed television/sound broadcasters.

Foreign exchange administration

Hong Kong does not have any foreign exchange control. There is no restriction on entry or repatriation of capital or remittance of profits from investments. Funds can be freely remitted outside Hong Kong by various means such as dividends, interest, royalties, service fees and branch profits, etc.

There is no government or other guarantees against inconvertibility.

Import and export issues

The Hong Kong Government is firmly committed to free trade and free enterprise. Consequently, relatively few controls are imposed over imports, exports and re-exports. Licensing formalities are kept to a minimum, and import and export licences are required only for dutiable commodities and certain specified goods.

Hong Kong has no major import restrictions. Prior import licences or other certificates may be required for the import of certain categories of goods, including dutiable commodities, arms and ammunition, dangerous drugs, pharmaceutical products, textiles, and certain foodstuffs, etc. Other permits such as Certificates of Origin may also need to be obtained to enable Hong Kong to fulfil its international obligations and for health, safety or security reasons.

Hong Kong is a free port imposing no customs duties (import tariffs) on imported goods. Excise duties are levied only on tobacco, hard liquor, methyl alcohol and hydrocarbon oil, whether imported or locally manufactured. Other taxes may also apply to items such as automotives, on which a first registration tax is charged. Re-exports represent a very significant component of Hong Kong's trade. In general, other than regular import/export formalities, there are no special regulations governing re-exports.

The appointment of a local agent is not mandatory, but can be helpful. Other options of local representation include retaining the services of local employees or salespersons or establishing a local sales subsidiary. Considerations will have to be given to the business needs as well as the tax implications of each of these options before making a decision.

Price control and unfair competition

The Hong Kong Government does not have any direct control over prices. The only exceptions in this regard pertain to certain organisations providing utilities services and to most forms of public transport. These organisations must obtain the government's prior approval for any price increases.

Currently, Hong Kong does not have competition law. The Hong Kong Government is committed to promoting competition to enhance economic efficiency and free trade, and introduced the Competition Bill into the Legislative Council in July 2010.

Intellectual property protection

Hong Kong is a leader in Asia in the protection and enforcement of intellectual property rights. Stringent laws regulate patents, copyrights, trade marks and registered designs. The Intellectual Property Department monitors the Intellectual Property regime and ensures the enforcement of the relevant laws and regulations. The Department is also responsible for investigating complaints against infringements and has extensive powers of search and seizure. Registration and protection of patents, copyrights, trade marks and registered designs are each governed by a separate ordinance.

Banking in Hong Kong

Who we are

One of the world's largest banking and financial services organisations, the HSBC Group had its beginnings in Hong Kong 147 years ago and Hong Kong remains one of its key markets and operating centres today.

Established in Hong Kong in March 1865 and in Shanghai one month later, The Hongkong and Shanghai Banking Corporation is the founding member of the HSBC Group. It is the Group's flagship in the Asia-Pacific region and the largest bank incorporated in Hong Kong. Known in Chinese as Wayfoong (which translates as 'focus of wealth' or 'abundance of remittances'), the bank is also one of Hong Kong's three note-issuing banks, accounting for around 62.5% of its banknotes. The Hongkong and Shanghai Banking Corporation Limited is a wholly owned subsidiary of HSBC Holding plc, the holding company of the HSBC Group. One of the world's largest banking and financial services organisations, HSBC Group has around 6,900 offices in 84 countries and territories serving around 60 million customers worldwide.

Awards

4th Consecutive Year
Best Trade Finance Bank in Hong Kong 2011, FinanceAsia.

5th Consecutive Year
Best Bank in Hong Kong, FinanceAsia Country Awards for Achievement 2011.

7th Consecutive Year
Best SME's Partner Award 2012, The Hong Kong Chamber of Small and Medium Business Limited.

7th Consecutive Year
Best Subscustodian in Hong Kong, The Asset Triple A Awards 2012.

4th Consecutive Year
Best Internet Bank 2011, Global Finance.

With our global experience and local knowledge, we can always connect you to a wealth of support, advices and services in Hong Kong, across the Greater China as well as throughout the world.

Commercial Banking

HSBC in Hong Kong serves over 430,000 small and medium-sized enterprises. We provide a full range of banking services to commercial customers including multi-currency business accounts, payments and cash management, wealth management and insurance, trade and supply chain, as well as a comprehensive range of financing solutions. Our expanded RMB trade settlement services also facilitate the trading business between mainland China and Hong Kong, paving the way for greater business success.

In addition, we provide one-stop cross-border banking services through International Banking Centres located in Hong Kong, the Mainland and Taiwan. Customers can open accounts from their local area, without the inconvenience of travelling directly to the region in which they wish to open an account. A Hong Kong and Taiwan team works on the Mainland, whilst a Taiwan and mainland China team works in Hong Kong.

We have the largest and most extensive banking network/channels in town. Products and services are distributed via branches, dedicated Business Centres, tele-banking centre, our award-winning Business Internet Banking and the newly launched Mobile Banking. Automated banking machines also enable cash and cheque deposits and cash transactions 24 hour a day.

Corporate sustainability

For HSBC, Corporate Sustainability is about bringing social and environmental issues together with financial performance to maintain and grow a successful business for the benefit of our stakeholders.

- We apply clear policies and processes to manage potential social and environmental risk in our lending and other financial activities in sensitive sectors.
- We help our clients to seize the opportunities presented by the shift to a low-carbon economy.
- We try to reduce our own environmental footprint and share good practice on this with our clients and other stakeholders.
- We focus our community investment (philanthropic activities) on education and the environment.

Our education programmes help to lift people out of poverty, build financial literacy and promote environmental awareness.

Our environmental programme focuses on the HSBC Climate Partnership – a five-year environmental programme to reduce the impact of climate change on people, forests, freshwater and cities. HSBC's programme partners are carrying out original scientific research, developing demonstration projects, creating working models, and proving clear solutions so that governments can enact legislation for the adoption of low-carbon policies.

Country overview

Capital city	Hong Kong
Area and population	Area of 1,104 sq km and population size of 7 million
Language	Chinese and English
Currency	Hong Kong Dollar
International dialling code	+852
National Holidays	Scheduled Public Holidays for 2013

New Year's Day	1 January
Lunar New Year's Day	10 February
The second day of Lunar New Year	11 February
The third day of Lunar New Year	12 February
The fourth day of Lunar New Year	13 February
Good Friday	29 March
The day following Good Friday	30 March
Easter Sunday	31 March
Easter Monday	1 April
Ching Ming Festival	4 April
Labour Day	1 May
The Buddha's Birthday	17 May
Tuen Ng Festival	12 June
Hong Kong SAR Establishment Day	1 July
The day following Chinese Mid-Autumn Festival	20 September
National Day	1 October
Chung Yeung Festival	13 October
The day following Chung Yeung Festival	14 October
Christmas Day	25 December
The first weekday after Christmas Day	26 December

Business and banking hours	Normal office hours are 9am to 5pm or longer (depending on the kind of business) on weekdays, and 9am – 1pm on Saturdays. Major banks are open 9am – 4:30pm on weekdays, and 9am – 12:30pm on Saturdays. Closed Sundays and public holidays.
Stock exchanges	Hong Kong Stock Exchange
Political structure	A Special Administrative Region of the People's Republic of China

Contacts

Cathy Jiang, Partner
Tax & China Business Advisory Services

Tel: +852 2289 5659

Email: cathy.kai.jiang@hk.pwc.com

http://www.pwc.com/gx/en/worldwide-tax-summaries

Website: www.hsbc.com.hk/business

Phone: +852 2748 8288

3rd Edition: November 2012

141TP_Hong_Kong_281112_3