



# **INTRODUCTION TO HONG KONG (+ GBA AND CHINA)**

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## **Table of contents**

|                                                |           |
|------------------------------------------------|-----------|
| <b>Introduction to Hong Kong</b>               | <b>1</b>  |
| <b>Hong Kong's legal system</b>                | <b>6</b>  |
| <b>Hong Kong employment and visas</b>          | <b>8</b>  |
| <b>Hong Kong tax environment</b>               | <b>12</b> |
| <b>The Greater Bay Area (GBA)</b>              | <b>15</b> |
| <b>Introduction to Doing Business in China</b> | <b>16</b> |

## **Introduction to Hong Kong**

### **Hong Kong Eye-openers**

- World's 7<sup>th</sup> largest trading economy in goods (but services still make up 90% of the economy)
- Diverse and evolving economy: no longer dependent on tourism and property
- Creative industries (arts, media, design, software, etc.) overtaking tourism as %age of GDP
- HK\$1.1 trillion, or US\$141 billion, of reserves
- A mature market of 7.5 million sophisticated, early-adopting consumers

### **Overview**

Hong Kong sits on Mainland China's southern coast and remains the major gateway to China, especially the burgeoning Greater Bay Area ("GBA"), China's manufacturing and technology hub, formerly known as the Pearl River Delta. Hong Kong's time zone is CET +7 hours.

Hong Kong returned to China in 1997, since when Hong Kong has been a Special Administrative Region with its own economic, judicial and education systems, guaranteed for 50 years by the "one country, two systems" arrangement. Since then, the city has had its ups and downs but the work ethic of its people has ensured that, overall, it has continued to prosper, and it lays strong claim to being the business and financial capital of Asia. Official figures state that around 6,000 overseas companies have based their Asia-Pacific operations in Hong Kong, employing around 250,000 people, although this is based on voluntary survey results and the true figures are probably considerably higher.

Chinese (both Cantonese and Mandarin) and English are the city's official languages, with English used as the main language of business. Hong Kong is a compact, efficient, and energetic city that is also one of the safest in the world. It is home to a large expatriate community that numbers around 500,000 out of a population of seven and a half million, and it has over 50 international schools for all age levels. Residents of Hong Kong enjoy one of the highest standards of living in the region and benefit from world-class services and amenities.

Despite the introduction of national security legislation, following civil unrest in 2019, Hong Kong remains an open, tolerant and pluralistic society. Although Hong Kong is ultra-modern, it presents a wide variety of architecture, both Western and Chinese – and it boasts structures designed by world famous architects such as I. M. Pei and Norman Foster.

Nevertheless, one is never far from the countryside in Hong Kong and there are hiking trails within even a few hundred metres of the city. In addition, there are mountains, forests, wetlands, nature reserves, beautiful (and usually uncrowded) beaches, country parks and islands. There is likewise a great range of sporting and cultural pursuits available and plenty of dining and nightlife options.

## **Reasons to invest in Hong Kong**

This is the Asian Century and China is the world's economic growth engine. Hong Kong is the perfect base from which to access the Greater Bay Area ("GBA") and the rest of China and of Asia, given its business environment and geographical position.

Hong Kong is only four hours away by plane from most of Asia's key cities and five hours away from half the world's population. It is an hour's drive (and as little as an 18 minute train ride) from the GBA.

The GBA accounts for 10 percent of China's GDP and about 30 percent of the country's exports, and thousands of overseas companies trading in China have established corporate entities for investment into or sourcing from the PRD in Hong Kong, due to the ease of setting up and doing business in and via Hong Kong.

Hong Kong's advantages include its pro-business governance, rule of law and independent legal system. Hong Kong has been ranked the world's freest economy and enjoys free flow of information, capital, talent and goods. The Hong Kong dollar is fully convertible and separate from the Chinese renminbi (RMB). In addition, Hong Kong has one of the world's lowest "tax misery" ratings, thanks to low tax rates, a territorial basis for tax, and a simple tax system.

Furthermore, Hong Kong has signed 45 (at the time of writing) double taxation agreements, thereby facilitating proper tax planning in a number of jurisdictions.

Hong Kong is also a logistics hub, for both sea and air freight. Hong Kong International Airport is (in normal times) the busiest international passenger airport in Asia-Pacific and the fourth busiest in the world; it also operates the busiest cargo facilities worldwide. Similarly, Hong Kong's container port is one of the busiest in the world, while Hong Kong's public transport and telecoms sectors are first rate.

Hong Kong people have an international outlook and commensurate business expertise. They are usually trilingual (English, Mandarin and Cantonese), highly trained, flexible and mobile. Hong Kong also has an open-door immigration policy to attract the best overseas professionals to come and work in the city. Spouses of expatriates have the right to work in Hong Kong.

## **How to set up a business in Hong Kong**

Setting up a company in Hong Kong is fast, straightforward and inexpensive, and can be up and running in under a week. The same rules apply to everyone, local and foreign.

Here are the steps in setting up a business in Hong Kong:

### **1. Selecting a company name and structure**

To register a local limited company in Hong Kong, you need to choose a unique company name. The Hong Kong Companies Registry maintains an index of company names and you can do an online check to see whether your desired company name is already in use.

There are three (main) different company structures to suit different business requirements:

The most commonly used company structure is a *private limited company*. The company must be incorporated at the Companies Registry and registered with the Business Registration Office of the Inland Revenue. Processing (incorporation) time is around four working days.

*A branch of a foreign company:* if a company incorporated outside Hong Kong establishes a place of business in Hong Kong, it is required to register with the Companies Registry within one month of the establishment of the place of business as an overseas company (under Part XI of the Companies Ordinance). It is not a separate legal entity from the parent. Processing time is from three to four weeks.

*A representative office* cannot make sales. Such an office is useful if a company wishes to explore the Hong Kong market before making a larger investment, or indeed if it is never intended to derive sales, e.g. if it is intended to be a marketing office only. It would typically fulfill functions such as promotion and liaison work. If a company needs to enter into a transaction that creates a legal obligation, its business structure will need to be changed to either a limited company or a branch office of a parent company.

All processing times are subject to completion of Client Due Diligence ("CDD").

## **2. Company incorporation**

Most of the limited companies incorporated in Hong Kong are private companies limited by shares. Incorporation can also be done online by approved service providers.

A private limited company in Hong Kong requires at least one director and one secretary. If a company has only one director, the director cannot be the secretary of the company at the same time. A non-Hong Kong resident, whether an individual or a corporate, can be appointed as a director. A company secretary is required by law and this must be (with very limited exceptions) a licensed Trust and Company Service Provider ("TCSP").

All new Hong Kong private companies will have to have at least one natural person as a director. This does not need to be a Hong Kong resident, although there is a requirement for each company to have a Designated Representative, who must be a Hong Kong resident, or a TCSP.

The registered office of a limited company must be situated in Hong Kong. There is no requirement for shareholders to be Hong Kong residents. A shareholder can be a director of the company.

## **3. Business registration**

All businesses, whether limited companies, sole proprietorships, representative offices or partnerships, must register with the Business Registration Office of the Inland Revenue Department. The annual business registration certificate costs HK\$450 (US\$60) and the Business Registration fee is HK\$2,000 (US\$256 – but currently waived). It is also possible to apply for a three-year certificate at a special rate. The Business Registration Certificate must be displayed at the registered office or the place of business. You must register within one month of commencing business.

## **4. Opening a business bank account**

Before a business bank account can be opened, you must complete business registration and company incorporation. Banks may also require due diligence documents to be provided or certified as originals and may also require a deposit and/or a processing fee.

## **5. Choosing business premises**

Hong Kong has a wide variety of business premises even within a close distance from its CBD. While property prices in the premium "Central" location can be very high, Hong Kong's compactness and excellent transport system mean that goodvalue sites can be found within short travelling distance of the CBD. The central corridor on Hong Kong Island extends from Sheung Wan in the west to Quarry Bay in the east, whilst accommodation is generally cheaper in Kowloon (across the harbour).

Office searches are normally arranged through an agent and procedures are straightforward. Renovations and refurbishment can be carried out quickly and economically.

*Leased offices* are typically leased for two or three years with an option to renew. A tenancy agreement covers the respective duties and obligations of landlord and tenant; a cash security deposit equivalent to up to three months rent, inclusive of service charge and government rates, is normally required from the tenant. Other office rental costs may include: a one-off fee to the property agent (normally equivalent to a month's rent shared between landlord and tenant); management service charges, which typically covers air conditioning, security, common areas, cleaning and other building services; government rates at five percent of annual rental value, payable quarterly in advance; and legal fees, should you engage a lawyer to process the tenancy agreement.

Some companies prefer the option of a *serviced or virtual office* when they first arrive in Hong Kong. Serviced offices are available across the city and allow for short-term leases, providing tenants with a range of secretarial services. Virtual offices provide a mailing address and a receptionist who will answer the phone in the name of the company. At the date of writing, Primasia Corporate Services Ltd. has workstations and individual offices for rent, with telephone answering and other administrative support

A number of *specialist centre* options are available for companies involved in science, technology, design or research and development. These companies typically require an office environment with specialised facilities and, possibly, incubator services. Service providers include Hong Kong Science & Technology Parks, the Hong Kong Applied Science and Technology Research Institute, Cyberport and the Hong Kong Design Centre.

## **6. Hiring staff and applying for work visas**

Please refer to the next chapter, "Hong Kong employment and visas", for details.

### **Business licences**

Some businesses will require licences or registration to conduct a specific activity. These include, among others: restaurants, travel agencies, employment agencies, banks, fund managers, insurance brokers and lawyers.

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## SUMMARY

- Overview of Hong Kong
- Consists of Hong Kong Island, Kowloon and The New Territories
- Time zone: CET +7
- Business language: English
- Political system: “One country, two systems”, with independent economic, judicial and education systems for 50 years starting 1 July 1997
- Reasons to invest in Hong Kong
- Proximity to the Greater Bay Area of China
- High status as an international business city and Asia’s leading financial centre
- The world’s freest economy
- Skilled labour force and liberal immigration policies
- Steps in setting up a business in Hong Kong
  1. Selecting a company name and structure: limited company / branch office of a parent company / representative office
  2. Company incorporation with the Hong Kong Companies Registry
  3. Business registration with the Inland Revenue Department
  4. Opening a business bank account
  5. Choosing business premises: leased offices / serviced or virtual offices / industrial buildings / specialist centres
  6. Hiring staff and applying for work visas
  7. Business licences

## **Hong Kong's legal system**

### **Overview**

Hong Kong became a Hong Kong Special Administrative Region (“SAR”) of the People’s Republic of China (“Hong Kong”) in 1997.

The Basic Law (Hong Kong’s constitution) came into effect on the same date. It provides that for a period of 50 years after the handover, Hong Kong will have a high degree of autonomy in its internal affairs. Hong Kong will run under the principle of “one country, two systems.”

Hong Kong’s legal system is based on English common law. Key principles of its legal system include the rule of law and independence of the judiciary.

### **Contract law in general**

In general, parties have complete freedom of contract in Hong Kong, and to enter into legally binding arrangements through contracts that govern their relationships. The legal enforcement of a contract is normally done through courts, but arbitration and mediation are increasingly considered (and encouraged – e.g. it is a requirement in litigation that arbitration has at least been first explored) as alternative means to resolve disputes in Hong Kong.

### **Intellectual property rights**

Hong Kong has intellectual property legislation, backed up by the independent judiciary, that provides the full protection of intellectual property rights of investors, guaranteeing that Hong Kong is a free and fair environment in which to do business. Intellectual property rights are protected under the following regimes:

- **Trademarks**

Under the Trade Marks Ordinance in Hong Kong, any sign that distinguishes the goods and services of one trader from those of another, which is capable of being represented graphically, may be registered as a trademark in Hong Kong. Distinctiveness is a key requirement for registration.

Once registered, the trademark prevents other traders from using a mark which is identical or confusingly similar to the registered trade mark.

Trademarks which are not registered may be protected under the law of passing off, whereby a trade misrepresents its goods or services for those of another by using a similar name.

The term for a registered trademark is 10 years from the date of filing the application. A trademark may be renewed for 10-year periods.

- **Copyright**

Under the Copyright Ordinance in Hong Kong, a work is protected if it is original, which means that the work must originate from the author and must not be copied from another work.

The author or creator of a work is the first owner of any copyright. In the event that a work is created by employees in the course of their employment, the employer will be the first copyright owner. (The rule in China is different.) The copyright for a work that is commissioned will depend on the agreement between the parties. In the absence of such an agreement, the copyright would belong to the author.

Copyright generally lasts for the duration of the life of the author plus 50 years.

- **Patents**

A patent registration may be applied for an invention which is novel, such as new products, substances, methods or processes.

A standard patent application is divided into two stages. The first stage involves filing a request to record a pending application in the United Kingdom, Europe or China. Once the overseas application has been granted, an application for registration and grant must be filed in Hong Kong within six months.

- **Registered designs**

A design product which can be registered must be new, and Hong Kong requires worldwide novelty.

The Registered Design Ordinance provides that the term of a registered design is five years from the date of filing the application and may be renewed for five-year periods, provided the total period does not exceed 25 years.

- **Trade secrets**

Trade secrets include confidential information in a commercial setting such as formulas, methods, technologies, business plans and client lists. In Hong Kong, trade secrets are protected by the common law of confidence. To be protected in this way, there must be the necessary quality of confidence about the information, conveyed under circumstances creating a duty of confidentiality and with the understanding that the use of such information will cause detriment to the owner.

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## SUMMARY

- Basic Law came into effect on 1 July 1997

- Contract law based on years of accumulated case law

- Intellectual property rights:  
trademarks/copyright/patents/registered designs/trade secrets

## **Hong Kong employment and visas**

### **Introduction**

Hong Kong offers a very business-friendly environment for employment, both for the recruitment of local staff and for the relocation to Hong Kong of overseas staff. In addition, Hong Kong offers a pool of multilingual (English, Cantonese and Mandarin) skilled labour with a strong work ethic. Labour disputes involving individuals are rare and strikes are virtually unknown.

In addition, Hong Kong's low tax rates are an incentive for both companies and individuals to relocate, and the city's open-door policy makes obtaining a work visa for employees or an investment visa for entrepreneurs easier than in most other jurisdictions.

### **Legal framework**

For the most part, Hong Kong employment law is straightforward, with most provisions and protections contained in the Employment Ordinance ("EO"), a single piece of legislation that cannot be contracted out of. The EO includes basic provisions such as minimum annual leave entitlements, due dates for payment of salary, and rules on dismissal, sick leave, maternity leave and so on. Anyone familiar with European rules will be pleasantly surprised to find that there are no complicated procedural requirements for terminations (first and second written warnings, etc.).

In theory, an employment contract is not even required under the EO, as the basic terms will be implied if nothing is formalised. However, employers are of course well advised both to put a signed employment contract in place and to take advice as to what is included. For example, simply "importing" an employment contract from the head office may risk including unenforceable terms (e.g. terms on non-competition, where Hong Kong law will strike out restrictions that are too severe), or over-generous – and therefore uncompetitive – terms (e.g. the EO provides for only seven days of annual leave, though many employers do in fact offer more).

Other aspects of the administration of staff are included in the Mandatory Provident Fund Ordinance covering the Mandatory Provident Fund (MPF), the Inland Revenue Ordinance covering Hong Kong profits and salaries taxes, and various anti-discrimination legislation.

### **Detailed provisions**

- **Paid annual leave**

An employee is entitled to paid annual leave based on the length of service. A progressive scale of minimum annual leave entitlements for employees based on the employee's length of service is provided by the EO. This ranges from seven days for employees with more than one year but less than three years of service, up to 14 days for employees with at least nine years of service.

- **Rest days**

An employee is entitled to not less than one rest day every seven days. This is in addition to statutory annual leave and statutory holidays.

- **Sickness allowance**

An employee accumulates two paid sickness days for each completed month of employment. After the first year of service, the employee would accumulate four paid sickness days for each completed month, up to a maximum accumulation of 120 days. Please note that this is a cap on the sick leave that can be taken, not a sick leave allowance.) An employee is entitled to sickness allowance only if his/her sick leave is for four consecutive days or more, and the

pay would be at the rate of four-fifths of the employee's daily average wage (although many employers pay sick days at the full rate).

- **Severance payment**

An employee who has been continuously employed for more than two years is entitled to severance pay if the employment is terminated by reason of redundancy or lay-off, such as when the employer has ceased to carry out business for the purpose of which the employee was employed. The amount of severance pay is calculated as two-thirds of the last full month wage of the employee or HK\$15,000, whichever is lower, for each year of continuous service, up to a maximum amount of HK\$390,000.

- **Long service payment**

An employee who has been continuously employed for five or more years is entitled to long service payment if the employee is dismissed for any reason other than redundancy or misconduct. Payment is due only if the employee does not receive any severance payment and does not enter into a new employment relationship with a new business owner following a change of business ownership. Payment is calculated in the same way as that for severance pay.

- **Offset of long service/severance payments**

An employer may recover his/her contributions to the employee's MPF scheme from any long service or severance payment made, although there are current legislative proposals which would remove this offset. However, this will be introduced in stages, with the government, rather than the employer, initially bearing the cost. **Other issues**

- **Termination**

Generally, employment may be terminated by the employer or employee without notice during the first month of service and with at least seven days' notice after the first month. In any other case, including employment under a continuous contract, unless summarily dismissed for good cause, if the contract does not provide for the notice period required, the notice period is deemed to be one month. If the length of notice is provided in the contract, then the notice period will be as agreed, subject to a minimum notice period of seven days.

No notice is required in the probation period.

- **Minimum wage**

The minimum wage in Hong Kong is currently HK\$37.50 per hour (approximately US\$4.80) per hour.

- **Mandatory Provident Fund (MPF)**

In Hong Kong, employers and employees must participate in an approved MPF scheme which is monitored by the Mandatory Provident Fund Schemes Authority (MPFA). Under the Mandatory Provident Fund Scheme Ordinance, if an employee has been employed for at least 60 days, the employer must enroll such employee in an MPF. Both the employer and employee are required to contribute 5 percent of the employee's income to the MPF fund enrolled. The maximum compulsory contribution for each party is currently capped at HK\$1,750.

- **Salaries tax**

Personal income tax is even easier to administer as it is generally the individual's responsibility to declare his/her income and to agree to settle his/her tax. The employer's responsibility is limited to reporting how much it has paid its employees, through a series of forms submitted to the Inland Revenue Department ("IRD"). In other words, the employer is not required to deduct tax or account for a deduction from the employee.

## **Visas**

Hong Kong is a separate travel area from Mainland China. Hong Kong has visa-free entry for residents from over 170 countries and territories for trips ranging from seven to 180 days. Short-term visitors may conduct business negotiations and sign contracts while entering Hong Kong on a visitor or entry permit.

Hong Kong has an open-door policy of actively encouraging people to contribute to the Hong Kong economy by working or investing in the city. Generally, foreign nationals must obtain a visa before coming to Hong Kong to live, work or invest. Below are the main business/investment visas:

- **Employment visa**

To employ people from overseas, it must be demonstrated that the proposed employee has special skills, knowledge or experience not readily available in Hong Kong. The proposed employee will need a sponsor (employer in Hong Kong) and must complete a visa application form. This form can be sent directly to the Immigration Department in Hong Kong, or to the Chinese Embassy or Consul-General in the applicant's home country.

- **Investment visa**

This visa requires you to be a shareholder of a Hong Kong registered company, either by registering and setting up a company in which you are the major investor, or by investing in a Hong Kong-based company. You will be required to produce details on the viability of your proposed business, or your financial position if you wish investment in an existing company to be the basis of your investment visa application. More recently, additional emphasis has been placed on showing that a certain investment amount is both available and intended to be made.

- **Dependent visa**

Persons who are successful in receiving one of the above-mentioned visas may also bring their spouse and dependent children under the age of 18 to Hong Kong, provided there are sufficient funds and suitable accommodation for them. The limit on dependents' stay is the same as that for the applicant sponsor. Normally, dependent visas are issued as a matter of course as long as the requisite relationships exist (e.g. a couple must be legally married) and there is suitable proof of actual dependency, as well as evidence of the sponsor's ability and willingness to support the applicant's dependency. A spouse holding a dependent visa is allowed to undertake any type of lawful employment in Hong Kong.

- **Hong Kong identity card**

Every adult, as well as every child aged 11 years or above, who enters and is permitted to stay in Hong Kong for more than 180 days must apply for a Hong Kong identity card within 30 days of arrival. Applying for the card from the Immigration Department is simple and is free. By law, you should carry your identity card with you at all times.

## SUMMARY

- Employment Ordinance as the main legal framework for employment in Hong Kong: covers paid annual leave / rest days / sickness allowance / severance payment / long service payment / offset of long service and others
- Visa categories: employment visa / investment visa / capital investment entrant scheme / dependent visa
- Hong Kong identity card

## **Hong Kong tax environment**

### **Introduction**

Hong Kong has a tax-friendly environment combining a territorial (or ‘source’) system of direct taxes with no capital gains tax, capital transfer tax, inheritance tax or VAT/GST. Direct income taxes in Hong Kong can be divided into profits tax, salaries tax and property tax. The tax year runs from 1 April to 31 March of the following year.

Hong Kong has negotiated a tax treaty network with 45 jurisdictions (at the time of writing), creating more international tax planning opportunities for cross-border investments. Its tax treaties increase Hong Kong’s attractiveness as one of the preferred Asian gateways for foreign investors to enter Mainland China and for Chinese enterprises to access the global market.

### **Profits tax**

#### **Scope**

Under the Hong Kong territorial tax system, persons or companies carrying out any trade, profession or business in Hong Kong are taxable on all profits arising in or derived from Hong Kong from such trade, profession or business. Consequently, income which does not have a Hong Kong source is not subject to profits tax.

The source of income and questions as to whether a business is carried out in Hong Kong and profits are derived from Hong Kong are largely questions of fact.

#### **Rate**

At present, the profits tax rates for companies and persons other than companies are 8.25% up to HK\$2 million of taxable profits and 16.5 percent thereafter, and 15 percent, respectively.

#### **Exemptions**

In addition, dividends received are not taxable in Hong Kong.

Furthermore, interest income derived from deposits placed in Hong Kong and qualifying debt instruments may, under certain specific conditions, be exempted from profits tax.

#### **Withholding tax**

Apart from the below case, no withholding tax is imposed in Hong Kong (e.g. on dividend distributions or interest payments).

The sole exception is that royalty payments to persons not carrying out business in Hong Kong are subjected to a 4.95 percent withholding tax. As an anti-avoidance provision, a 16.5 percent withholding tax applies if the recipient of the royalty payments is a company associated with a Hong Kong taxpayer and the intellectual property rights were previously owned by a Hong Kong taxpayer.

### **Salaries tax**

#### **Scope**

According to the Hong Kong territorial tax system, all income arising in or derived from Hong Kong from any office, employment or pension is taxable in Hong Kong. In deciding whether income arises in or is derived from Hong Kong, it is necessary to establish where the source of income is located. Consequently, a person is exempted from salaries tax on his/her income which has not been derived from Hong Kong.

“Income from any office and employment” may include different forms of advantages and allowances in monetary and nonmonetary terms from the employer or any associated company of the employer.

A husband and wife who are not living apart may elect to be jointly assessed for salaries tax on their aggregated income.

### Rate

Salaries tax is charged on net taxable income at the lower of the standard rate of 15 percent or at progressive rates as follows:

#### 2020/21

|                                      |     |
|--------------------------------------|-----|
| First HK\$50,000                     | 2%  |
| Next HK\$50,000                      | 6%  |
| Next HK\$50,000                      | 10% |
| Next HK\$50,000                      | 14% |
| Balance (subject to overall 15% cap) | 17% |

### Personal allowances

Personal allowances for the year of assessment 2020/21 can be claimed by taxpayers before determining the salaries tax to be paid according to progressive rates.

Allowances applicable to progressive rate taxpayers are as follows:

| <u>2020/21</u>          | <u>HK\$</u> |
|-------------------------|-------------|
| Personal allowance:     |             |
| ▶ Single                | 132,000     |
| ▶ Married               | 264,000     |
| Single parent allowance | 132,000     |

### Exemption

A non-resident can be exempted from salaries tax on his/her income from a Hong Kong employer, provided that he/she does not visit Hong Kong for over 60 days in a tax year running from 1 April of the current year to 31 March of the following year. This is commonly known as “60 days exemption”.

Expatriates working in Hong Kong under non-Hong Kong employment are subject to salaries tax based on their physical presence in Hong Kong. However, their income attributable to services rendered outside Hong Kong can likewise be tax exempted. This partial exemption claim is commonly called “time apportionment claim”.

Residents of jurisdictions with which Hong Kong has signed a tax treaty can be exempted from salaries tax if their stay in Hong Kong does not exceed the threshold of 183 days and meets other conditions as stipulated in the tax treaty.

Special provisions apply to crews of ships and aircraft that visit Hong Kong for short spans of time and persons who have paid tax of substantially the same nature as Hong Kong salaries tax in any territory outside Hong Kong.

## **Property tax**

### **Scope**

Owners of land and/or buildings in Hong Kong are subject to a property tax computed at the standard rate on the net assessable value.

Companies carrying out business in Hong Kong are exempt from property tax but subject to profits tax.

### **Rate**

The standard rate for 2020/21 is 15 percent.

## **Tax treaties network**

Hong Kong has 40 comprehensive tax treaties in place or ratified with major trading and investment partner countries.

**Very broadly speaking**, the withholding tax on dividends will be only 5%, and there will be no withholding tax on interest.

Please note that in order to benefit from the reduced withholding tax rates granted by a tax treaty, it is important to address eventual anti-treaty shopping or tax avoidance rules that may be applicable in the tax treaty and/or a partner country’s domestic legislation. These rules may require, for example, having sufficient “substance”, such as a physical presence, in the treaty country.

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## **SUMMARY**

- Profits tax: 8.25/16.5 percent for companies with exemption for capital gains and dividends offshore income
- Salaries tax: 15 percent or progressive rate
- Property tax: 15 percent with specific exemption
- Tax treaties: networks and partners

## **The Greater Bay Area (GBA)**

The Greater Bay Area or GBA, also known as the Pearl River Delta, is effectively a megacity consisting of nine cities and two special administrative regions, or SARs, one of which is Hong Kong, in southern China.

The GBA has a urban population of 72 million. There are normally around 250 million border crossings between Hong Kong and the rest of the GBA area per year.

The formal concept of the area as a discrete development area dates from late 2016, since when transport infrastructure – roads, rail, bridges and tunnels – have been significantly developed and integrated. (For rail, Hong Kong’s own MTR has been the model. The MTR also runs overseas railways, such as the Stockholm metro and the MTR Express between Stockholm and Gothenburg.)

Shortest traveling times for trains departing from Hong Kong’s West Kowloon Station are: about 14 minutes to Futian, about 18 minutes to Shenzhen North and about 46 minutes to Guangzhou South .

At the same time, with the active support of the Chinese government, the Chinese mainland parts of the GBA, i.e. the nine cities, have been actively developed as a technology hub in parallel with, and complementing, Hong Kong’s own government supported start-up support programme.

However, although the GBA’s development has been encouraged and supported by the Chinese and Hong Kong governments, it is really only an extension of the role the area has played as Hong Kong’s manufacturing back yard for over 30 years and the synergies between Hong Kong and the rest of GBA are far from artificial.

The GBA’s manufacturing expertise is a natural development dating from Hong Kong’s factories having relocated across the border from the 1980s onwards and other Foreign Direct Investment into China having followed Hong Kong’s example. The growth and success of the GBA are based largely on Hong Kong’s long experience as a sourcing base for China (trading and logistics account for over 20% of Hong Kong’s GDP and over 700,000 people employed). Many major retailers have sourcing offices in Hong Kong, often situated within easy reach of the border, and there are indeed “sourcing clusters” in Hong Kong again usually near the border with China. Some retailers are even picking and packing at store level for worldwide shipment.

The rise up the value chain including better quality control and the movement into product design and R and D is a seamless extension of that initial manufacturing know-how. The GBA is now being used by companies for design and prototype development under their Hong Kong entities with easy access, relaxed visa rules, and some tax concessions

Nowadays, relaxed visa requirements make it easy to utilise the R and D, prototype development, quality control and manufacturing of products on a daily basis from a Hong Kong corporate and residential base.

In addition, recent changes to Chinese tax rules mean that daily visits to the GBA do not count as “days in” in China, and so do not give rise to a personal tax liability. In other words, individuals can continue to benefit from Hong Kong’s low tax rates whilst effectively working in China.

## **Introduction to Doing Business in China**

### **Major issues in doing business in China**

Foreign companies should consider the following factors when determining their method and place of incorporation in China:

- Their business needs, whether for trading, manufacturing, export or plain networking. It may not be necessary to establish a legal presence in China, with all that entails;
- The regional differences in incorporation requirements and tax systems;
- Incentives from local governments;
- Supply chains for specific industries in different regions.

Following a decision on the approach and location of set-up, foreign companies should apply due diligence and prepare for:

- Adapting the procedures and requirements for company incorporation and licence applications applicable to their own business type and selected regions;
- Complying with foreign currency controls on fund transfers in and out of China;
- Meeting the requirements of various layers of tax systems and types;
- Coping with cultural differences at the country and district levels in terms of commercial concepts as well as employer– employee and social relationships.

#### **1. Foreign Investment Guidance**

This is a PRC government publication which covers eligible and forbidden business natures and industries, as well as the respective capital and incorporation requirements for eligible businesses. It is subject to review from time to time.

The current version covers four categories, namely the “encouraged”, “permitted”, “restricted” and “prohibited” categories. Industries relating to environmental protection, improved extraction of natural resources, waste management, recycling energy efficiency, venture capital and IP and high technology are among the “encouraged” industries.

Anything not “encouraged”, “restricted” or “prohibited” is “permitted”.

#### **2. Four main types of foreign investment set-up**

Before deciding how to establish a business in China, foreign investors must be aware of and define their long-term and medium-term objectives. There are various corporate set-up options available, such as equity joint ventures, cooperative joint ventures, wholly foreign-owned enterprises and representative offices. Each form has its own legal requirements, benefits and advantages. Below is a brief description of each one:

- **Equity joint venture (EJV) enterprises**

These are enterprises established in China as a result of joint investment with foreign individuals, firms and/or Chinese economic organizations, based on the principle of equality and mutual benefit, and subject to approval by the Chinese government.

An EJV takes the form of a limited liability company with the status of a Chinese legal entity. It requires joint contributions of both parties in investment, operation, share of profits, risk and losses, in strict proportion to the amount of investment contributed by the respective parties. In general, the level of investment offered by the foreign investor should be at least 25 percent. Investment can be in the form of cash, real estate, industrial property, equipment and technology, but these types of investment need to count as different shares in the investment.

- **Contractual joint venture enterprises (CJV - also known as cooperative joint ventures)**

As for the EJV, CJVs are established in China as a result of joint investment or cooperation with foreign individuals, firms and/or Chinese economic organizations, based on the principle of equity and mutual benefit, and subject to approval by the Chinese government.

However, a CJV has more flexibility in terms of contractual freedom and structure; that is, profits and losses are distributed between the Chinese party and the foreign investor in accordance with specific contractual provisions, as opposed to their respective equity interests in the CJV.

Capital contributions to both EJV and CJV can be in cash or in kind, such as buildings, machinery, materials, and knowhow. For a CJV, the parties can decide how the value of their contributions should be determined, whereas for an EJV, this evaluation process normally needs an independent third party to assess the “market price” of the contributions.

A CJV project usually involves the foreign partner providing most or all of the funds and technology as well as key machinery, whilst the Chinese partner contributes land, facilities, natural resources and perhaps a limited amount of funding. However, China’s economic environment has changed. Land has become a rare resource and Chinese companies are not short of money; therefore nowadays forming a CJV has become far less popular.

- **Wholly owned foreign enterprises**

Wholly owned foreign enterprises (WOFEs) are those set up in China by foreign individuals or firms where the investment is 100 percent provided and operated exclusively by foreign investors (without any Chinese partners). According to Chinese law, if several foreign partners jointly invest in a company, it will also be regarded as a WOFE.

A WOFE is a legal entity and is a limited liability company. The liability of the shareholders is limited to the assets they brought to the business. Setting up a WOFE requires currency input or equipment contribution, and the registered capital must correspond to the enterprise’s business scale.

In recent years, the Chinese government has steadily increased the scope of businesses allowed to WOFEs, such as consulting, management services and trading. However, although WOFEs can engage in an increasing range of sectors, some restrictions still exist on specific industries (see the section above on the Foreign Investment Guide).

WOFEs offer an advantage in that foreign investors have complete control over major decisions, products, and costs. They also allow strategic alignment with the parent company and greater control over (hence protection of) intellectual property.

The following is a summary of the characteristics of WOFEs:

- 100 percent foreign ownership
- 100 percent management control
- Limited liability: An investor’s liability is limited to its share of the WOFE’s registered capital (equity).

Manufacturing JVs and WOFEs are subject to a Chinese value-added tax (VAT) of 3-13 percent and a corporate income tax of 25 percent (since the 2008 reforms). The former business tax has now been abolished and replaced by “additional tax” at a rate of 12% as part of the VAT tax.

There are two types of tax payers: small scale tax payer and general tax payer. Small-scale VAT tax rates are basically 3%, but rates for general taxpayers are set according to industry standards (13%, 9%, 6%). If the annual taxable sales of taxpayers (the amount of invoice issued for 12 consecutive months) exceed 500,000 yuan for industrial enterprises, 5 million yuan for commercial enterprises and 5 million yuan for service enterprises, the company should apply for general taxpayer status as soon as possible according to the requirements, otherwise the tax bureau will suspend services to the company.

- **Representative offices**

The representative office (RO) is an office set up in China by a foreign investor (including foreign companies and economic organizations). Compared to other foreign entities in China (JVs and WFOEs), applying for an RO business licence is quite simple and easy, except in some special industries such as banking, insurance, security and investment. Most RO applications do not need any Central government approval and are directly submitted to the local Administration of Industry and Commerce. (Please note that the Chinese government is now discouraging ROs in favour of WOFEs.)

However, an RO is not a legal entity. An RO (like its Hong Kong namesake) can only carry out liaison and coordination work, market research and promotion for its parent company. An RO is not allowed to conduct other business activities such as signing contracts in its own name and invoicing, to name a few.

An RO is subject to business tax, normally approximately 10 percent to 12 percent of its total expenses (i.e. deemed profit), including office rental, staff salary, travelling and other office expenses.

The following is a summary of the characteristics of an RO:

- Not a legal entity
- Conducts research and promotion
- No invoicing

### **Major tax categories for foreign investment enterprises and foreigners**

Since China adopted a reform and opening-up policy in the late 1970s, foreign investment has played an increasingly important role in the country's economic growth. Hundreds of thousands of foreign investment enterprises and foreign enterprises are in operation in China. A number of taxes are applicable to enterprises with foreign investment, foreign enterprises and foreigners in China in accordance with regulations set by the National People's Congress, its Standing Committee and the State Council of China.

Chinese tax authorities have been paying more attention to international tax collection and administration. The division of taxation and tax policymaking powers between levels of authorities is still largely determined by the Central government, rather than through legislation. Under the existing taxation regime in China, there are mainly three taxation collection systems, namely state tax bureaus at various levels, local tax bureaus at various levels and Customs.

Generally, state tax bureaus have the power to levy certain taxes (e.g. enterprise income tax and value-added tax), while taxes imposed by local authorities include the individual income tax, business tax and stamp tax. Customs is mainly responsible for collecting customs duty and consumption tax. The following content briefly summarises the major tax

categories for foreign investment enterprises and foreigners. For more information, please refer to “Tax System of the People’s Republic of China State Administration of Taxation” at <http://english.tax861.gov.cn/zgszky/zgszky.htm>.

## Value-added tax

Value-added tax (VAT) is payable by enterprises and individuals who sell merchandise, who import goods or who supply services, such as processing, repair and replacement. Unlike in Western countries, VAT is not imposed on all services in China.

## Consumption tax

Consumption tax is levied on the production, processing or importation of certain specific consumable goods in China.

## Customs duty

Customs duty is levied by the customs authority on imported and exported goods in order to raise state revenue and to protect domestic industries.

## Additional tax

Additional tax follows VAT tax and consumption tax. As long as VAT tax or consumption tax is declared, additional tax is necessarily to be declared as well. It contains three categories: urban maintenance and construction tax, educational surcharge, and local educational surcharge. Normally the rate is 12% on the VAT tax.

## Enterprise income tax

In general, foreign companies are taxed on their China-source income whether they have any permanent establishment in China or not.

|                                                                                                                                                 | Taxable<br>China-source income | Taxable<br>foreign-source income |
|-------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|----------------------------------|
| Resident enterprises*                                                                                                                           | ✓                              | ✓                                |
| Non-resident enterprises,** if income is effectively connected with their China establishment                                                   | ✓                              | ✓                                |
| Non-resident enterprises, if they do not have any China establishment, or if income is not effectively connected with their China establishment | ✓                              | ×                                |

Notes:

\* Resident enterprises: incorporated or effectively managed in China \*\*

Non-resident enterprises: incorporated and effectively managed outside China

## Individual income tax

Individuals who have resided in China for less than one year should pay individual income tax on their incomes derived from sources within the country. Those who have resided in China for one year or more should pay individual income tax on their income derived from sources both inside and outside China.

## **Land appreciation tax**

Land appreciation tax is levied on gains arising from the transfer of the right to use state-owned land and the buildings that are constructed on this type of land.

## **Urban real estate tax**

A tax of 1.2 percent is imposed on foreign investment enterprises and foreign national owners of real estate, or at the rate of 12 percent of rental income.

## **Stamp duty**

Stamp duty is payable on instruments created in the process of economic activity, on the documents written.

## **Vehicle and vessel tax**

Those who own or operate vehicles and vessels should pay a vehicle and vessel tax in China; otherwise, the user should pay the tax on behalf of the owner or the operator of a vehicle.

*Foreign investors tend to assume that the tax laws in China are fairly straightforward, that as long as they provide proper documentation they can deal with such laws themselves without expert advice. Nevertheless, there are various complex rules covering numerous aspects of the business activities of foreign investment enterprises in China, particularly when preferential policies are provided to foreign investment enterprises. Both investors and companies need to find practical ways to keep updated with the latest information on regulations and laws. In a nutshell, it is suggested not to disregard or delay seeking professional advice on Chinese tax laws; otherwise, foreign investors may face serious penalties or losses due to underpayment.*

## **Possible obstacles for foreign companies running businesses in China**

- Different regulations imposed on foreign companies running businesses in China by different government authorities at the country and regional levels: These regulations need to be fully understood to avoid breach of laws and regulations.
- Government authorities involved with the set-up and running of foreign businesses in China work very differently from those in other countries.
- There is no single step of company incorporation and business license application. In general, it takes two to four months to obtain all the approvals/certificates/licences on one application.
- There are complex taxation systems at state and local levels.
- There are differences in the working styles of Chinese government authorities and foreign companies. • There are different perspectives on environmental, cultural and ethical issues, among others.

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## SUMMARY

- Foreign Investment Guidance – Chinese government’s encouragement of foreign venture benefiting economics, the environment and the long-term development of China. Preferred industries are environmental and high-tech, as well as VC and IP.
- Four main types of foreign investment set-up in China:
  - Equity joint venture enterprises
  - Contractual joint venture enterprises/ cooperative joint ventures
  - Wholly foreign-owned enterprises
  - Representative offices
- Major tax categories for foreign investment enterprises and foreigners:

|                         |                          |
|-------------------------|--------------------------|
| • Value-added tax       | • Consumption tax        |
| • Customs duty          | • Additional tax         |
| • Enterprise income tax | • Individual income tax  |
| • Land appreciation tax | • Urban real estate tax  |
| • Stamp duty            | • Vehicle and vessel tax |