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**GUIDES TO FOREIGN INVESTORS
SETTING UP BUSINESS IN HONG KONG**

PKF

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Introduction

After 156 years of British administration, the People's Republic of China ("China") took back the sovereignty of Hong Kong on 1 July 1997 and established the Hong Kong Special Administrative Region of China ("Hong Kong") on the same day. The Chinese central government assures through the enactment of the Basic Law that the socialist system shall not be practised in the territory and the way of life shall remain unchanged for 50 years (i.e. up to year 2047). With this "One Country, Two Systems" policy, Hong Kong continues as a low tax, free port and capitalist territory. The Basic Law further provides, inter alia, that:

- Hong Kong shall be vested with executive, legislative and independent judicial power including that of final jurisdiction.
- Hong Kong shall retain her status as an international financial centre. Her market for foreign exchange, gold, securities and futures will continue. There will be free flow of capital within, into and out of the territory. Hong Kong dollars will continue to circulate and remain freely convertible.
- The current social and economic systems in Hong Kong shall remain unchanged. Private property, ownership of enterprises, legitimate right of inheritance and foreign investment will be protected by law.
- Hong Kong shall maintain the status as a free port and shall not impose any tariff unless otherwise prescribed by law.
- The law previously in force in Hong Kong shall be maintained.

You should appreciate that apart from the replacement of a new national flag, there is not much change in Hong Kong. She is still one of the few governments in the world that practices free enterprise policy. There are no restrictions on foreign investment, no restrictions on the repatriation of capital and profits, free exchange controls, excellent telecommunication system and simple territorial tax regime. Hong Kong also continues to adopt the well-established common law based legal system, which is very familiar to foreign investors. Both foreign and local corporations are registered under the same rulings and are subject to the same sets of business regulations and taxes. In view of her strategic location and extremely well developed infrastructure, many foreign investors also prefer to route their investments through Hong Kong into China. Hong Kong therefore remains as one of the most popular places of investment in the world after the handover.

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Legal Requirements for Setting-up Business in Hong Kong

Foreign investors can set up virtually any type of business in Hong Kong without first obtaining government approval (except for banking, insurance and shipping business). However, every person commencing business in Hong Kong must register with the Business Registration Office ("BRO") within one month of the date of business commencement. A valid business registration certificate will be issued by the BRO and must be displayed to the public at every place of business. Such certificate has to be renewed annually. The current business registration fee is HK\$2,600 per annum.

I. Limited Liability Company

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

1. Before a company is incorporated, its name must be registered first and approved by the Companies Registry ("CR"). The registrar will reject a proposed name if it is identical to or cause confusion with another company name already on the CR. Then the foreign investor can proceed with the registration procedures.

A lot of professional firms in Hong Kong including our associate, Hongkong Managers and Secretaries Limited ("HKM"), can provide such services to clients.

2. There is a statutory minimum of one shareholder and one director for setting up a limited company. Anyone (corporation or natural person) can be a shareholder and director of a Hong Kong company. There is no restriction on foreigners acquiring shares in Hong Kong companies. All the shares can be registered in the name of persons residing outside Hong Kong. Beneficial owners may also appoint nominee shareholders to hold the shares if they wish to keep their identities confidential.
3. Hong Kong company is required to have a statutory secretary. It also must have an address in the territory and the statutory secretary has to be a resident in Hong Kong if it is an individual. Where a corporation acts as the statutory secretary, it must have its registered office or place of business in Hong Kong. Our HKM will be pleased to act as the statutory secretary for its clients.
4. There are no other requirements as to the minimum amount of share capital. Consequently, many Hong Kong companies are established with a paid-up share capital of HK\$2 only. It is advisable for authorised capital to be kept as low as possible in order to reduce the capital duty (i.e. 0.1% on the par value of the issued shares). But it is sometimes necessary to have a large share capital in order to fulfil the assets backing requirement of the bankers, business partners or customers etc.
5. If every thing is in order, it takes around two weeks to incorporate a limited liability company. However, there are also some ready-made companies in the market, which are available for immediate use.

6. When the company is duly registered with the CR, the registration with the BRO is much more simple. Either the director or the company secretary can represent the company to apply for the business registration certificate.
7. Hong Kong company has to hold one annual general meeting of the shareholders and at least one director's meeting every year. Directors' meeting can be held in any country of the world. Shareholders' meeting can also be held outside Hong Kong provided that there is nothing to prevent this in the Articles of Association. The minutes of the meetings are often prepared by the professional firm acting as the statutory secretary.
8. Every year, Hong Kong company must complete an Annual Return and file with the CR where it is available for public inspection. The Annual Return gives details of a company's share capital, members and directors.
9. Hong Kong company has to keep proper books of accounts. The accounts have to be audited by an auditor holding a practising certificate issued by the Hong Kong Institute of Certified Public Accountants. The company is not required to file audited accounts with the CR. Therefore, the company's financial positions are not made available to the public for inspection. But the annual audited accounts have to be submitted to the Hong Kong Inland Revenue Department ("IRD") together with the annual corporation Profits Tax Return for assessment.

II. Branch of a Foreign Company

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

1. A certified copy of the Memorandum and Articles of Association of the head office corporation or other instrument defining its constitution. If the instrument is not written in Chinese or English, a certified translation of the document is required.
2. A list of the name, nationality and residential addresses of the directors and shareholders of the company.
3. The name and address of at least one person resident in Hong Kong who is authorised to accept legal notices served on the company.
4. Name and address of the company's statutory secretary.
5. The address of the principal place of business of the Hong Kong branch.
6. The address of the principal place of business and registered office of the foreign company in its place of incorporation.

7. A memorandum of appointment or power of attorney authorising a person to accept legal notice of the company in Hong Kong.
8. A certified copy of the company's certificate of incorporation and a certified translation of the certificate if it is written in a language other than Chinese and English.

III. Representative Office of a Foreign Company

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

- i. The representative office does not conclude contracts in Hong Kong other than domestic contracts for employing staff, purchasing furniture and fixture etc.
- ii. The representative office does not maintain accounts in Hong Kong.
- iii. The representative office receives no income in Hong Kong.

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

IV. Sole Proprietorship

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

V. Partnership

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

VI. Joint Venture

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

Factors to be Considered for Doing Business in Hong Kong

Hong Kong is a free port. For trading business, there are no export restrictions from the Hong Kong Government and import duty only applies to petroleum and hydrocarbon oils, tobacco and alcohol.

I. Volume of Business Transactions

When a foreign investor sets up a Hong Kong company, there are sometimes insufficient transactions for it to justify the employment of staff in the early stage of trading. Our HKM can provide the services that would normally be carried out by the company's employees. For instances,

- i. operating the bank accounts including the receipt of money and the payment of expenses;
- ii. preparing invoicing and other documentation;
- iii. negotiating letters of credit through the bank; and
- iv. arranging international transfer of money etc.

Thus, the foreign investor can defer its incorporation expenses until the business goes steady. Actually, with a proper arrangement, the profits generated by a Hong Kong trading company from offshore business can be exempted from Profits Tax.

II. Personnel

Preliminary expenses such as travelling and hotel charges involved in setting up a physical office in Hong Kong can be costly. However, the most difficult part may be the appointment of appropriate personnel to represent the investor's interests in Hong Kong. The personnel can be seconded from the investor's country or recruited locally. Although the cost for local recruitment is comparatively cheaper, it takes time to establish trust relationship between the investor and the staff. Whether appropriate personnel can be appointed or not may sometimes depend on luck. Secondment of overseas staff could be very expensive unless he or she accepts local scale of remuneration.

An employment visa has to be applied for overseas staff before he or she can work in Hong Kong. For application of visa, financial proof is required from the sponsor, which normally is the employer of the applicant in Hong Kong. Special arrangement will be required for substantiating the financial conditions when the newly incorporated company will be the sponsor. Our HKM can provide the recruitment service and visa application services to the company upon request. Other supporting staff can be recruited locally. The monthly salary depends on nature of work, experience and educational background of the staff.

Employers may visit the website of the Hong Kong Labour Department (<http://www.labour.gov.hk/>) for more information about the statutory employment requirements in the territory.

III. Mandatory Provident Fund Scheme

Hong Kong is implementing a Mandatory Provident Fund (“MPF”) scheme. Therefore, it will be an additional cost to foreign investors.

1. An employer in Hong Kong is required to make arrangements for relevant employees aged between 18 and 65, who have been employed for 60 days or more, to join a registered MPF scheme. It can select one or more MPF schemes managed by the licensed trustees in the market (e.g. HSBC, Standard Chartered Bank and the licensed insurance companies) and then arrange the relevant employees to join the scheme.
2. Mandatory contributions are calculated on the basis of 10% of an employee’s relevant income. The employer and its employee each are required paying 5% to the scheme.
3. Maximum and minimum income levels have been set for mandatory contribution purposes. If the employee’s income is less than HK\$5,000 per month, he or she will be exempted from making mandatory contributions but the employer is still required to contribute an amount equals to 5% of the employee’s income.
4. If the employee’s income exceeds HK\$20,000 per month, the employer and the employee are only required to contribute 5% of HK\$20,000 each (i.e. HK\$1,000 per month) to the scheme. Of course, they can opt to make extra, voluntary contributions in addition to the mandatory contributions.
5. If the employees belong to any one of the following categories of persons, the employer and the respective employees are NOT required to join the MPF schemes:-
 - i. employees who have attained 64 years of age;
 - ii. household employees;
 - iii. self-employed hawkers;
 - iv. people covered by statutory pension and provident fund schemes (e.g. Hong Kong civil servants and teachers);
 - v. members of occupational retirement schemes that are granted exemption certificates;
 - vi. people from overseas who enter Hong Kong for employment for less than one year; or people from overseas who are covered by overseas retirement schemes; and
 - vii. employees of the European Union Office or the European Commission in Hong Kong.

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

IV. Physical Office

Depends on the locations of office, monthly rental varies considerably from an average of HK\$250 per m² in the business centre of Hong Kong to HK\$100 per m² in some less commercial area. With a suitable choice of the location, foreign investor can save a lot of rental expenses. There are many well-established property agents in Hong Kong that have established their websites. Foreign investors can obtain the latest rental information in different locations from these websites free of charge.

V. Taxation in Hong Kong

Hong Kong operates a simple territorial tax system. There is no capital gain tax, dividend tax, sales tax, value-added tax nor fringe benefit tax. The IRD only levies taxes under three separate headings:

1. Property Tax

Property tax is levied on rental income generated from land and buildings situated in Hong Kong. The tax is computed at 16% on the net assessable value of the letting property, which is equal to 80% of its gross rental income after deducting the rates.

2. Salaries Tax

Salaries tax is charged against an individual on his or her income from any office, employment and pension including wages, salary, fees and commissions arising in or derived from Hong Kong. The IRD will regard salary income as derived from Hong Kong if the fundamental source of employment is in Hong Kong or if the income is derived from services performed in the territory.

3. Profits Tax

Every individual, corporation, partnership or unincorporated business ventures carrying on a trade, profession or business in Hong Kong is subject to tax on profits which are generated from sources within the territory. Profits of unincorporated business are currently chargeable to tax at a rate of 16% and corporations at 17.5% for the year ending on 31 March 2005. For a receipt to be taxable in Hong Kong, the following conditions must be satisfied:

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

In computing the assessable profit, the company is entitled to deduct business expenses that are incurred in earning its taxable income. Deductions of capital expenditure are prohibited.

The IRD grants a system of allowance on certain qualifying capital expenses for the purpose of a trade, profession or business in Hong Kong including assets falling within the definition of plant and machinery, industrial buildings and commercial buildings.

- i. Plant and machinery allowances comprise an initial allowance of 60% on acquisition cost and annual allowances of 10%, 20% or 30% on the estimated working life of the particular category of plant or machinery. Items qualifying for the same rate of annual allowance are grouped under one "pool".
- ii. Industrial building allowance of 20% on construction costs of building used in certain trade such as transport, the manufacture, processing or storage of goods will be granted. An additional allowance of 4% on the expenditure is also granted annually until the total construction cost is written off.
- iii. Commercial building allowances are granted for expenditure on construction of a building other than industrial building at the rate of 4% per annum on cost.
- iv. Capital expenditure incurred on certain prescribed fixed assets in any year of assessment is allowed to be fully written-off. "Prescribed fixed assets" include computer hardware and software, and certain defined plant and machinery that are used specifically and directly for any manufacturing process.
- v. Capital expenditure on refurbishment of a building or structure (other than a domestic building or structure) can be amortized over a period of five years at 20% per annum.

Concluding Remarks

As compared to other tax heaven countries, Hong Kong is almost the lowest tax region, which is also a major commercial and financial centre. She is located at the centre of Asia and has a world-class airport operating on 24-hour basis. Daily non-stop flights are available to many countries in the world. For instances, taking a flight from the Hong Kong International Airport, business executives can reach most Asian countries within five hours. They can also travel to and from Beijing, Shanghai and other major cities of the Mainland China in a single day while making their homes in Hong Kong.

Accordingly, any tax efficient arrangements can be based on normal trading activities such that the accumulation of profits at a low tax rate in Hong Kong can be justified to tax authorities of many home countries of foreign investors. Hong Kong company can act as the regional headquarter of the multinational group company whereby it carries on active business in the territory and accumulates profits, as much as possible, to finance the group's future business expansion in the Asia Pacific region. ※