

How can a Hong Kong Incorporated Company be Exempted from Tax?

Clement Lam [June 1999]

There is a growing trend that many overseas clients request our associate, Hongkong Managers & Secretaries Limited (“HKM”), to assist them in setting up corporations in Hong Kong (“HKCo”) to conduct the so-called “re invoicing business”. The rationale behind is driven by commercial motives. Overseas investors prefer Hong Kong to other locations is largely connected with her strategic location of being a stepping-stone to the mainland China market and the well-developed infrastructure including free repatriation of profits, free exchange control, excellent banking, transportation and telecommunication systems etc.

Reinvoicing Business Operations

If the following conditions are fulfilled, HKCo can also get tax exemption agreement from the Hong Kong Inland Revenue Department (“IRD”) on its profits generated from the reinvoicing business.

- a. HKCo does not establish any office nor employ any staff in Hong Kong. It simply appoints a professional service company, such as HKM, to provide the secretarial services in order to comply with the minimum statutory requirements of the Hong Kong Companies Ordinance.
- b. HKCo’s related company or associate at overseas (“Overseas Associate”) is fully responsible for marketing, sourcing of goods, negotiation and conclusion of business contracts.
- c. When Overseas Associate negotiates and finalizes the terms of sales with overseas customers, it notifies the overseas suppliers to deliver the goods directly to the customers. Then, it instructs the HKM to:
 - ♦ make payments to the suppliers;
 - ♦ type the relevant invoices;
 - ♦ operate HKCo’s bank account;
 - ♦ arranging letters of credit; and
 - ♦ record the transactions in HKCo’s accounts.

If HKCo conducts business in the above manner, the IRD will accept that the company does not generate any Hong Kong sourced profits. It simply acts as a “bookkeeping centre” (through HKM) in accordance with the instructions from Overseas Associate. The administrative works performed by HKM in Hong Kong are purely incidental functions, which are not instrumental in earning the company’s trading profits and, of course, give no indication of a source of profits in Hong Kong. Accordingly, HKCo will fall outside the scope of charge under Section 14(1) of the Inland Revenue Ordinance.

Reinvoicing operations work well in Hong Kong. Being one of the major business centers in the world, it is easy to put commercial substance into transactions and invoke fewer questions from tax authorities than elsewhere. But, of course, commercial considerations always dictate the final choice of how to operate HKCo in real life. Overseas investors therefore should consult their qualified advisors, particularly where unusual or complex situations are involved, before taking any action.

TYPICAL REINVOICING BUSINESS OPERATION FLOWCHART

