

CEPA – A Springboard for Hong Kong Companies to Enter China Market

Clement Lam & Wallace Ng [January 2004]

The central government of the People's Republic of China and the government of Hong Kong Special Administrative Region signed the Mainland and Hong Kong Closer Economic Partnership Arrangement ("CEPA") on 29th June 2003, whereby China agreed to impose zero tariffs on 273 categories of Hong Kong products and to provide earlier and preferential market access to the Hong Kong based companies in 18 service sectors of China. CEPA has become effective on 1st January 2004

The public generally considers that CEPA will bring new business opportunities to Hong Kong by enhancing Hong Kong's position as the service center of Mainland China and open up the door for Hong Kong companies to explore the China market. Moreover, it can also act as a buffer to assist Hong Kong in passing through the process of economic restructuring. In view of the potential of the huge China market, the opportunities available to Hong Kong companies appear to be unlimited.

What are the benefits of CEPA?

Comparing with the WTO commitment made by China, CEPA provides Hong Kong manufacturers and service suppliers with the following main advantages:-

1. Earlier market access

Through eliminating tariff on various Hong Kong products and lowering the entry requirements, CEPA allows Hong Kong manufacturers and service suppliers to enter into the China market one to five years ahead of the WTO timetable. This allows Hong Kong companies to get a head start to build up strategic network and business base in the country.

2. Lower entry requirements

CEPA lowers the capital and assets requirements for industries such as distribution and wholesales, retailing, freight forwarding agency and banking business etc. This offers opportunities to Hong Kong small to medium sized companies to explore the fast-growing China market.

3. Recognition of qualifications

Under CEPA, many Hong Kong professional qualifications will be recognized in China and are allowed to take China professional exams. This creates great opportunities for the Hong Kong professionals in broadening their client base and explores the China market.

4. **Greater equity holding in Chinese investments**
Under the WTO's commitment, foreign investors are still required to operate some of their business in China in the form of Joint ventures. The level of equity holding is also restricted in many cases. However, under CEPA, it is possible for Hong Kong companies to form wholly owned foreign enterprises ("WOFE") in China. This allows Hong Kong companies to take complete control of their China businesses.

Why CEPA is a win-win-win arrangement?

1. **For Foreign Investors:**
Foreign investors can take advantage of CEPA through partnering with or acquiring a Hong Kong qualified company to gain access to the China market. They can enjoy various preferential treatments such as zero tariffs on Hong Kong made products, earlier and higher market liberalization, greater equity ownership in Chinese enterprises and lower investment threshold. Some of these offers even go further than the commitments made by China government to the WTO members.
2. **For Hong Kong Companies:**
Hong Kong companies can gain earlier access to China market and enjoy various advantages offered by CEPA. As Hong Kong has a mature legal system and strict intellectual property legislation protection, it is expected that CEPA also can attract high value-added manufacturing activities to be located in the territory. This would effectively accelerate the economic recovery of Hong Kong and create new job opportunities.
3. **For Mainland China:**
With abundant supply of land and labor, China is very successful in attracting foreign investors to set-up manufacturing bases in the country and has won the name of "the World's factory". However, the service industry of China is still at its initial stage of development.

In contrary, Hong Kong is a major service center in the Asia Pacific region. Her GDP for the service industry covered about 85% of its total GDP in 2002. CEPA indeed provides a perfect match for two sides. The development of the China's service industry can be accelerated as experienced Hong Kong service companies enter into the market. The Chinese manufacturers can also acquire high-quality business support from Hong Kong services providers such as banking, financial, logistics and management consulting services etc. and thus, enhancing their competitiveness in the global market.

I. CEPA FOR MANUFACTURING COMPANIES

Under CEPA, China agrees to apply zero tariffs on 273 categories of products exported from Hong Kong with effect from 1st January 2004. It is also agreed that China will apply zero import tariffs for other products at the latest by 1st January 2006 upon applications by local manufacturers. It should be noted that, to enjoy the above benefit, there is no need for a company to be based in Hong Kong. Nevertheless, the goods exported to China must be qualified as “Made in Hong Kong”.

For the goods to be qualified as “Made in Hong Kong”, they must satisfy the requirements in accordance with the “rule of origin” as prescribed under CEPA. It means that the goods must have been *wholly obtained* or *substantially transformed* in Hong Kong. The Trade and Industry Department is authorized by the Hong Kong government as the certification organization to issue the Certificates of Origin under CEPA to qualified applicants. According to the Annex 2 of CEPA, the origin of products is determined in accordance with the following principles:-

1. goods *wholly obtained* in Hong Kong are regarded as originating in Hong Kong;
2. for goods not wholly obtained in Hong Kong, they can be regarded as originating in Hong Kong if they have undertaken *substantial transformation* in the territory.

The first principle can be understood easily. However, It should be noted that the following activities are specifically considered as “minor processing treatment” in the Annex 2 and will not be taken into account in determining whether the goods are wholly obtained in Hong Kong or not:

- a. processing or treatment for transportation or storage of goods;
- b. processing or treatment to facilitate packaging and delivery of goods; and
- c. processing or treatment such as packaging or display for distribution and sale of goods.

The second principle is more common when applying to the practical situation in Hong Kong, where a company imports raw material or work-in-progress from other countries and processes them into finished goods for exporting to China.

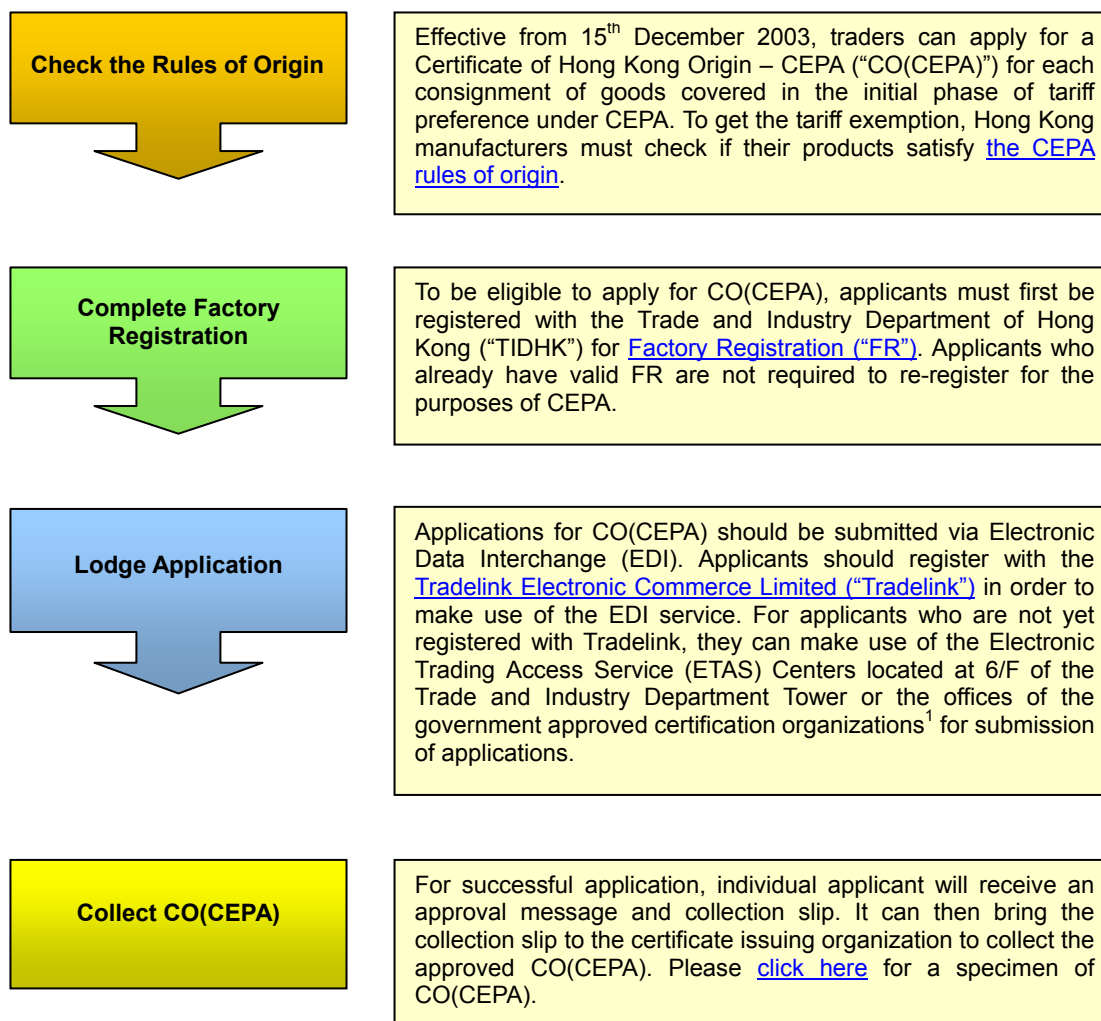
The criteria for determining “substantial transformation” may be assessed by the criteria listed as below:-

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

Notes:

- Under the Annex 2, simple diluting, mixing, packaging, bottling, drying, assembling, sorting, decorating as well as processing or treatment for the purpose of transportation, storage, delivery, packaging or display are not regarded as substantial transformation.
- Please [click here](#) for the detailed table regarding rules of origin in respect of different categories of products (*Source: The Trade and Industry Department of Hong Kong*).

Application Procedures



Notes:

1. The Government Approved Certification Organizations refer to:-
 - i. [Hong Kong General Chamber of Commerce](#);
 - ii. [Federation of Hong Kong Industries](#);
 - iii. [The Chinese Manufacturers’ Association of Hong Kong](#);
 - iv. [The Chinese General Chamber of Commerce](#); and
 - v. [The Indian Chamber of Commerce Hong Kong](#).
2. CO(CEPA) is valid for 120 days from the date of issue. An expired certificate will not be accepted by the Customs Office of China.

II. CEPA FOR SERVICE PROVIDERS

Under CEPA, China agrees to open up its market to Hong Kong service suppliers in 18 service sectors. The qualified service suppliers can gain access to the China market earlier than the WTO timetable and are allowed to set up WOFE in the country.

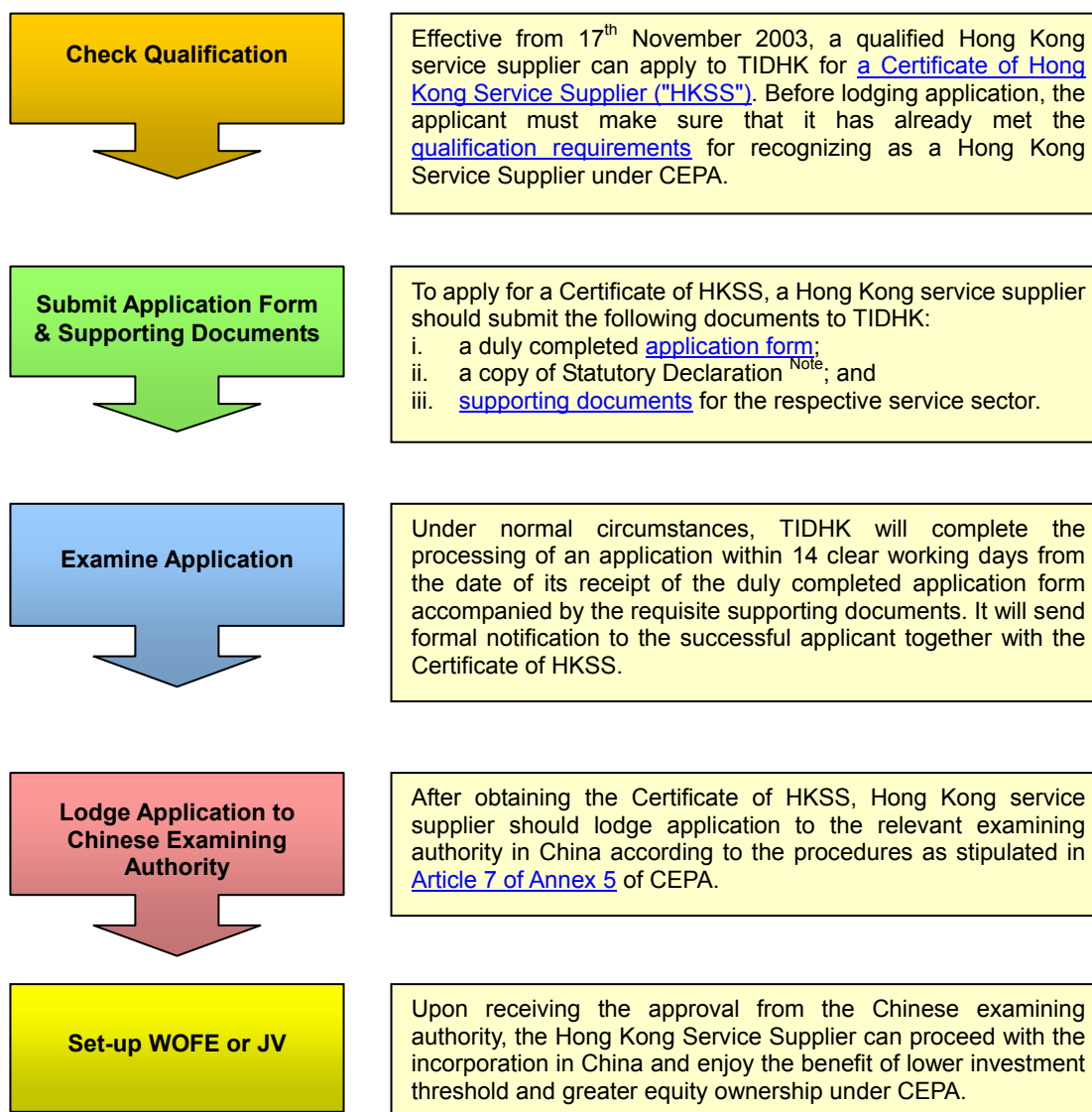
Qualifications of “Hong Kong Service Supplier”

It should be noted that not all Hong Kong companies could be qualified as “Hong Kong Service Suppliers”. They must meet the following criteria in order to enjoy the benefits of CEPA:

1. The service suppliers must be incorporated or established under the Companies Ordinance or other relevant laws of Hong Kong. Registered overseas companies in Hong Kong, their offices, liaison offices, mail box companies and companies specifically established for providing certain services to their parent companies are not qualified as “Hong Kong Service Suppliers”.
2. The service supplier must engage in *substantive business operations* in Hong Kong. The criteria for determination are:-
 - a. The nature and scope of the services provided by the service suppliers in Hong Kong should encompass the nature and scope of the services they intend to provide in China; and
 - b. The service suppliers should be incorporated or established in Hong Kong and have engaged in substantive business operations for 3 years or more. However, if a non-Hong Kong entity has acquired or merged with a Hong Kong service provider on or after 29th June 2003, and as a result of the acquisition or merger, the non-Hong Kong entity acquired more than 50% of the equity interests of the Hong Kong service provider, that Hong Kong service provider will be qualified as “Hong Kong Service Supplier” after one year of the acquisition or merger; and
 - c. During the period of substantive business operations in Hong Kong, Hong Kong service suppliers should have paid profits tax in accordance with the relevant law; and
 - d. Hong Kong service suppliers should own or rent premises in Hong Kong to engage in substantive business operations. The scale of their business premises should be commensurate with the scope and the scale of their businesses; and

- e. More than 50% of the staff employed by the Hong Kong service suppliers should be residents staying in Hong Kong without any limitation, and people from China staying in Hong Kong on the One Way Permit.

Application Procedures



Note:

The statutory declaration must be made by the applicant's authorized person in accordance with the procedures and requirements of the Oaths and Declarations Ordinance (Cap11) of the HKSAR and must be attested by an attesting officer recognized by China. China Recognized Attesting Officers refer to practicing lawyers in Hong Kong registered under the Legal Practitioners Ordinance (CAP 159) of the HKSAR, who are recognized by the Ministry of Justice of the People's Republic of China. Please [click here](#) for a list of the recognized attesting officers.

IV. CONCLUSION

CEPA creates favorable business environment facilitating Hong Kong companies to explore the fast-growing China market. The Hong Kong companies and foreign investors should review their present operations and investment plans to see how they can realize the advantages being offered by CEPA. For foreign investors planning to go into China, they should evaluate whether it is advantageous to acquire or partner with a Hong Kong qualified company so as to enjoy the preferential treatments under CEPA. ※

For more details, please contact:

Clement Lam

PKF Hong Kong

Tel: +852 2806 3822

Fax: +852 2806 3712

E-mail: clementlam@pkf-hk.com