

The Closer Economic Partnership Arrangement (“CEPA”) – A stepping stone into China Mainland Market

Thomas Yeo, Principal
PKF Shanghai

The CEPA was the first free trade agreement signed between Mainland China and Hong Kong was on 29th June 2003. Since then, the supplement expanded every year and fifth supplement (CEPA V) was signed on 29 July 2008. The purpose of the CEPA is to strengthen the economic relationship between Hong Kong and China Mainland open up the huge mainland markets for Hong Kong goods and services in phases. CEPA is equivalent to Free Trade Agreement (FTA) signed between countries, where it fully abides by the requirements under World Trade Organization (WTO).

The CEPA is deemed to be a win-win arrangement, as not only will bring new business opportunities to the China Mainland, Hong Kong also benefits from the CEPA as it allows the businesses to gain greater access and freedom to the Mainland market, from zero tariffs on imported goods to preferential treatment on service sectors. On the other hand, the Mainland enterprises can also benefit from the closer economic ties that Hong Kong share with the global markets.

In accordance to the General Administration of Customs, the imported Hong Kong products through 23 Mainland ports has valued over US\$1 billion by mid 2007, with tariff exemption over Rmb770 million. The objectives of the CEPA are mainly:

CEPA Objectives

Faster / easier access to the China Mainland Market for service and manufacturing industry

100% ownership on most of the China invested entity

Easier route in/out of China via Hong Kong

Zero tariffs on 90% of Hong Kong exports into China

China mainland manufacturer able to use Hong Kong services

CEPA for manufacturing and trading

Under CEPA, Hong Kong and overseas Company will benefit from the zero tariffs agreement on 90% of Hong Kong products exports into China, covers around 1,510 product categories. CEPA only deals with import tariff, while value added tax and other PRC domestic taxes are not exempted.

Hong Kong origin products were both appealing and expensive to mainland consumers, mainly due to the high import taxes. CEPA offers new business opportunities to HK manufacturing sector. Where the tariff free arrangement can help increase the competitiveness of Hong Kong goods and price in the China mainland market, as compared with goods imported from overseas.

Hong Kong locals, China mainland and overseas investors are able to setup manufacturing facilities in Hong Kong so that their products, which has to be substantially transformed in Hong Kong, could be classified under “Made in Hong Kong” in qualifying for the CEPA origin rules to obtain the tariff free when exporting to the China mainland.

Company must obtain the certification of Hong Kong origin to benefit from the tariff free arrangement, which is administrated by 5 government approved certification organizations.

5 Approved Certification Hong Kong Organisations

Federation of Hong Kong Industries

The Chinese General Chamber of Commerce

The Chinese Manufacturers' Association

The Indian Chamber of Commerce

CEPA not only gives Hong Kong a head start over potential foreign competitor in accessing the China Mainland market, the agreement also establishes the country as a competitive manufacturing location for high-value products, especially products with strong design or valuable trademarks.

Criteria for determining 'substantial transformation'	
Manufacturing or processing operations	The principal manufacturing or processing operations which confer the essential characteristics to the final product are carried out in Hong Kong.
Change in tariff heading	The processing and manufacturing of non-originating materials to be carried out in Hong Kong and resulting in a substantial product differentiation or transformation that resulted in a product of a different four-digit tariff heading under the 'Product Description and Harmonized System Codes'. The 4 digit tariff coding refers to an internationally standardized system for classifying traded products, which is structured by economic activity or component material.
Value added content	The total value of labour, product development, component parts and raw materials to more than or equal to 30% of the free-on-board value of the goods, which includes R&D and design costs.
Other criteria	Methods agreed by both Hong Kong and China in determining 'substantial transformation', other than 'manufacturing or processing operations', 'change in tariff heading' and 'value-added content' as set out above.
Mixed criteria	Two or more of the above criteria in determining origin.

Investors could either setup a manufacturing plants in Hong Kong or outsource to Hong Kong factories to satisfy the Rules of Origin. To speedup in obtaining the CEPA status, investors could also consider in partnering or investing in a company which already

has a CEPA status.

Using Hong Kong's free port system, raw materials or semi-made products could be imported into Hong Kong tariff free. Factories in Hong Kong could then manage the specialized stages of the design, manufacturing and IP protection of the product. The products could then be exported tariff free into China for further mass production, distribution or exported to the rest of the world.

	Product Types (As at 30 Sep08)	Cumulative No. of CO (CEPA) Applications Received	Cumulative No. of CO (CEPA) Approved
1	Food and Beverages	10,406	10,215
2	Food Residues and Animal Fodder	55	55
3	Chemical Products	2,193	2,114
4	Pharmaceutical Products	5,030	4,950
5	Colouring Matters	1,422	1,395
6	Cosmetics	63	55
7	Plastics and Plastic Articles	5,354	5,295
8	Leather and Fur-skin	43	39
9	Paper and Printed	1,267	1,217
10	Textiles and Clothing	10,711	10,229
11	Glass and Glassware	2	-
12	Jewellery and Precious Metals	419	417
13	Base Metal Products	1,673	1,650
14	Machinery and Mechanical Appliances	20	20
15	Electrical and Electronic Products	575	555
16	Optical, Photographic and Cinematographic Instruments & Parts	149	143
17	Clocks and Watches and Parts Thereof	220	202
18	Furniture	1	1
19	Toys and Games or Sports Requisites	1	1
20	Miscellaneous	5	5
	Total	39,195	38,142

Current Tariff rates on imported goods to China

Types of Goods	Examples of Goods	Current applied tariff rates (%)
Aquatic Products	Certain dried or processed fish etc.	10 -16
Food and Beverages	Certain dairy products; certain, fruit juices; fresh ater, ice and active yeast; etc.	10 - 25
Chemical products	Gypsum and anhydrite; cement clinkers; oleic; certain diagnostic or laboratory reagents; certain mortars and concretes; etc.	4 - 16
Mechanical and electrical products	Machinery and apparatus for purifying water; certain elevators and conveyers and their parts; parts of certain machinery; certain electric drills and saws; vacuum cleaners; etc.	5 - 25
Metal products	Certain tube or pipe fittings; containers for compressed or liquefied gas; tin and certain tin products; certain wire, rods, electrodes of base metal; etc	1.5 - 18
Plastic Products	Certain plastics in primary form; certain plastic plates, sheets, films, foils, strips and tubes, etc; certain plastic household articles; etc	6.5 - 10
Spectacles	Spectacle lenses of glass; frames and mountings for spectacles; sunglasses and other spectacles; etc.	10 - 20
Textiles and Clothing	Certain fabrics; certain overcoats, anoraks, skirts, trousers, suits, swimming suits, tracksuits, underwear; babies' garments; shawls and scarves; gloves;	10 – 25
Others	Animal feedings; sail; certain automobile parts; illuminated signs; etc.	5 - 20

CEPA for service sectors

With CEPA V signed on 29 Jul, it was committed to open up 29 July 2008, the agreements now covered 39 service sectors that establishes greater freedom in market entry as they could bypass some of the stringent regulations. Besides, Professional bodies of Hong Kong and the regulatory authorities in China have also signed a number of agreements or arrangements on the mutual recognition of professional qualification.

Any company, foreign or domestic, can apply as a Hong Kong company and take advantage of CEPA, provided that it meets the following criteria:

CEPA Requirements on Companies

Must be a registered and established company according to Hong Kong regulations and has been operating for 3 to 5 years depending on industry
The nature of the business it wishes to start in the Mainland must be the same as the business nature in Hong Kong
50% or more of the staff the company employs must be from Hong Kong
The company is liable for Hong Kong profits tax
Premises of the business for daily operations must be owned or rented

The following are examples of the preferential treatment for Hong Kong Service Company. For more details on other service industry, please kindly contact any of PKF Shanghai advisers.

Legal services — many more business opportunities are available to Hong Kong lawyers as they can provide professional assistance requested by Mainland law firms since they will not require a 'Hong Kong legal consultant' permit. Furthermore, Hong Kong lawyers can also take up employment in Mainland law firms, but will not be able handle issues regarding to Mainland law. Furthermore, if a Hong Kong law firm has a representative office in the mainland, it is permitted to operate as long as a partnership exists with a mainland law firm in the same province.

Retail — Permanent residents of Hong Kong with Chinese citizenship is allowed to be set up individual owned retail stores in China. Also allow HKSS company to set up wholly owned company for franchise purpose in accordance to the relevant regulations.

Futures and securities companies — CEPA allows easier access for Hong Kong futures and securities companies to enter the China market as it promotes financial service cooperation between Hong Kong and the Mainland.

Convention and Exhibition — allows enterprises set up by Hong Kong service suppliers (HKSS) wholly owned, equity joint venture or contractual joint venture in Beijing, Tianjin, Chongqing, and Zhejiang to organize overseas exhibitions on a pilot basis.

Banking — allows any Mainland-incorporated banking institution established by a Hong Kong bank to locate its data centre in Hong Kong, subject to fulfilment of certain requirements.

Construction and related engineering services — allows Hong Kong professionals obtaining Mainland's registered Urban Planner or Supervision Engineer qualification to register/ practise in Guangdong regardless of whether they are registered practitioners in Hong Kong or not; and also remove restriction on the proportion of the total capital contributed by the Mainland partners in setting up construction and engineering design enterprises in the form of equity joint venture or contractual joint

venture in the Mainland;

39 Service sectors Open up in China Mainland		
Accounting	Information Technology	Real Estate and Construction
Advertising	Insurance	Related Scientific and Technical Consulting Services
Air Transport	Job Intermediary	Securities and Futures
Audiovisual	Job Referral Agency	Services incidental to Mining
Banking	Legal	Services related to Management Consulting
Building-cleaning	Logistics	Social Services
Computer and related services	Management Consulting	Sporting
Convention and Exhibition	Market Research	Storage and Warehousing
Cultural	Medical and Dental	Telecommunications
Distribution	Patent Agency	Tourism
Environmental	Photographic	Trade Mark Agency
Freight Forwarding Agency	Printing	Translation and Interpretation
Individually Owned Stores	Public Utility	Transport (including road freight / passenger transportation and maritime transport)

Social services for persons with disabilities — to allow HKSS to operate welfare agencies for persons with disabilities in the form of wholly-owned private non-enterprises in Guangdong on a pilot basis

Tourism — Guangdong authority could now approve applications submitted by HKSS for setting up travel agents on a wholly-owned, equity joint venture or contractual joint venture in Guangdong; and

also allow

Accounting — extend the validity period of the "Provisional Licence to Perform Audit-related Services", applied for by Hong Kong accounting firms for the purpose of conducting auditing business on a temporary basis in the Mainland, from two years to five years; and to set up dedicated examination centres in Hong Kong, Shenzhen and Dongguan for Hong Kong residents to sit the Mainland's accounting qualification examinations, with exemptions on few subjects ; In addition, the validity of temporary licenses for Hong Kong accounting firms to conduct auditing business will be extended from two years to five years.

Medical and Dental— allow HKSS to set up whollyowned outpatient clinics in Guangdong. There will be no total investment requirement in setting up outpatient clinics by HKSS in Guangdong. In addition, there will be no restriction on the ratio of capital investment between HKSS and Mainland service suppliers in setting up outpatient clinics in the form of equity joint venture or contractual joint venture in Guangdong.

Advertisement — to allow HKSS to setup wholly owned company in China.

Travel Agent — to allow HKSS to setup wholly owned (WFOE) or joint venture company in China with minimum capital requirement decreased for WFOE from US\$12.5mil to US\$8mil

CEPA for trade and investment facilities

CPEA also covers a series of measures to make business between China Mainland and Hong Kong easier and more efficient. Measures cover customs clearance, inspections and quality standardisation, e-business, transparency in legal issues and improving intellectual property protection.

Areas	Strengthened Cooperation
Customs Clearance Facilitation	Establish a customs information exchange system between China Mainland and Hong Kong. Exploring the feasibility of data networking and the development of electronic customs clearance at control points and enhances efficiency in customs clearance through technical cooperation.
Quarantine and Inspection of Commodities, Quality Assurance and Food Safety	Strengthen cooperation on inspection and monitoring of electrical and mechanical products, sanitary, food safety, health. Also improve on quarantine supervision, product certification and accreditation, standardization management.
Cooperation of Small- and Medium-sized Enterprises (SMEs)	Strengthen information exchanges between SMEs via organizing frequent exchanges, visits and Explore jointly the strategy and support policy to assist the development of SMEs between the two sides.
Cooperation in Chinese Medicine and Medical Products	Strengthen information sharing in regulation formulation, development strategies and in the direction of development for Chinese medicine and medical products. Promote jointly the commercialization of Chinese medicine and medical products and make advancements in the international market.
Electronic Commerce	Strengthen the cooperation of the two sides in the research and formulation of rules, standards and regulations for electronic commerce and in its corporate use. Promote and provide training for electronic commerce and electronic government.
Trade and Investment Promotion	Strengthen mutual trade and investment promotions between the two sides. Cooperate in the joint development of international markets for commodities and engineering works.
Transparency in Laws and Regulations	The two sides will strengthen cooperation and strive to provide information to their commercial and industrial enterprises with a view to promoting bilateral economic and trade flows.

Future developments

CEPA is a framework which is constantly evolving with further liberalizations on trade in goods and services with the mainland, and other areas of cooperation in the future. With Hong Kong being a leading financial centre and Mainland China having the fastest growing economy in the world, hand in hand, the partnership between them both will allow a very prosperous path for many years to come.

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