An Introduction to

Doing Business in Hong Kong 2017
About Dezan Shira & Associates

At Dezan Shira & Associates, our mission is to guide foreign companies through Asia’s complex regulatory environment and assist them with all aspects of establishing, maintaining and growing their business operations in the region. Since its establishment in 1992, Dezan Shira & Associates has grown into one of Asia’s most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore and Vietnam, as well as liaison offices in Italy, Germany and the United States, and partner firms across the ASEAN region. With over 25 years of on-the-ground experience and a large team of professional advisers, we are your reliable partner in Asia.
The People’s Republic of China regained sovereignty over Hong Kong from Britain in 1997, from which point it has been a Special Administrative Region (SAR) of the country. However, the way in which the city is governed is still fundamentally different from the Chinese mainland – a fact that is reflected in its slogan of “One Country, Two Systems”. Hong Kong is largely autonomous from China, and foreign companies will quickly discover that the rules of doing business in the mainland simply do not apply in Hong Kong, and vice versa.

For this reason, Hong Kong has long held a reputation as a popular “gateway” to invest in China. Its geographical proximity to the mainland, double taxation agreement (DTA) network, modern banking system and transparent legal regime have made it an ideal location for foreign businesses to easily operate in. While the Foreign Account Tax Compliance Act (FATCA) has stoked fears that this position may soon change – primarily because the act has caused some Hong Kong banks to turn away American corporations and individuals – Hong Kong remains the biggest source of foreign direct investment (FDI) into China, making up US$78.26 billion of a total US$107.25 billion from January to November 2016.

This publication, designed to introduce the fundamentals of doing business in Hong Kong, was created at the beginning of 2017 using the most up-to-date information at the time. It was compiled by Dezan Shira & Associates, a specialist foreign direct investment practice that provides corporate establishment, business advisory, tax advisory and compliance, accounting, payroll, due diligence and financial review services to multinationals investing in emerging Asia.

Since its establishment in 1992, Dezan Shira & Associates has grown into one of Asia’s most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore and Vietnam, partnership offices in Indonesia, Malaysia, the Philippines and Thailand, as well as liaison offices in Germany, Italy and the United States. Dezan Shira & Associates’ experienced business professionals are committed to improving the understanding and transparency of investing in emerging Asia.
A Brief Overview of Hong Kong

Political system

The Hong Kong Special Administrative Region (HKSAR) is currently ruled by China’s Basic Law – the constitution adopted by the National People’s Congress of the PRC on April 4, 1990. HKSAR was established on July 1, 1997, after Great Britain returned Hong Kong to the People’s Republic of China (PRC).

Under the Basic Law, Hong Kong is allowed to retain the social, economic and legal systems present at the time of the handover for a 50 year period under the principle of “One Country, Two Systems.” Additionally, the Basic Law designates a system of governance led by the Chief Executive, who is the head of the HKSAR, and the Executive Council, which assists the Chief Executive in policy-making issues.

Legal system

Due to its previous status as a British colony, Hong Kong’s legal system is largely influenced by English common law. The constitutional framework for Hong Kong’s legal system is provided by the Basic Law approved by the National People’s Congress, which supplements the common law. The independent judiciary under the Basic Law ensures that Hong Kong remains within the common law system. The Court of Final Appeal is the highest court in HKSAR and is headed by the Chief Justice. Furthermore, reflecting its status as a Special Administrative Region, the HKSAR legal system is separate from the one governing the PRC under the principle of “One Country, Two Systems.”

Economic system

Hong Kong’s economic system is defined as a free market economy and characterized by minimum intervention from the government. HKSAR is service oriented, and especially strong in the financial services, international trade, and tourism sectors. Additionally, it has strong economic links to mainland China and other major economies in the Asia Pacific region.

The lack of tariff and non-tariff barriers to trade has made Hong Kong an attractive destination for investors. HKSAR has no tariffs on imported goods, no import quotas, and applies excise duties to only four commodities. Furthermore, Hong Kong has no taxes on dividends generated from doing business in the region. Free trade and low taxation has helped Hong Kong to be ranked as the world’s freest economy for 22 years in a row.
Financial system

The Hong Kong financial system is composed of four different financial regulators, each one governing different parts of the financial sector. These include the Securities and Futures Commission (SFC, an independent body set up to regulate the securities and future markets), the Mandatory Provident Fund Schemes Authority (MPFA, a statutory body set up to assist Hong Kong’s workforce to accumulate savings for their retirement), the Office of the Commissioner of Insurance (OCI, a body set up to protect the interests of policyholders and promotes the general stability of the insurance industry) and the Hong Kong Monetary Authority (HKMA, the government’s agency responsible for maintaining monetary and banking stability).

Despite the HKMA’s role as the currency board and de facto central bank, it does not print currency notes itself. Instead, it grants Hong Kong dollar printing privileges to HSBC, Standard Chartered Bank and the Bank of China.

Under the Linked Exchange Rates System (LERS), the Hong Kong dollar has been pegged to the US dollar since 1983, at a rate of HK$7.80 to US$, which has helped maintain monetary stability. Through the exchange rate system, the HKMA authorizes note-issuing banks to issue new banknotes, as long as an equivalent amount of US dollars is deposited with the HKMA.
Economic Outlook

Hong Kong’s economic outlook in 2017 will remain largely dependent on the global economy, in particular the slowdown in China and the US interest rate rise, which are expected to shape its prospects over the coming year. The SAR’s economy is forecasted to experience another slow year in 2017, with GDP growth at about 1.9 percent. Stock market volatility remains a key risk in the region but confidence in the local bourse is expected to be buttressed by the Shenzhen-Hong Kong Stock Connect, which was launched on December 5, 2016. This, together with other pioneering policies, will help support the sustainable growth of the banking and finance sector.

Trading volume will continue to fall along with the slowdown in demand from China, although the magnitude of the decline is expected to be smaller than that in 2016. The retail and tourism sectors are also expected to remain lackluster amid strong competition from cheaper destinations such as Japan, South Korea and the Eurozone, whose attractiveness to visitors has increased due to their devalued currencies. Hong Kong’s competitiveness could further erode if China further devalues the RMB, as it did in 2015 and 2016.

China Briefing believes that any interest rate hikes in 2017 will be gradual and minimal. However, an increase in lending rates would reduce household spending power, leading to a fall in private consumption. A rise in US interest rates would likely be followed by further currency appreciation, which would cause the HK$ to follow suit. Any appreciation in the HK$ would further damage exports and tourist consumption. Domestic spending could also face some headwinds as local shoppers opt to spend more overseas.

The employment sector will remain exposed to downside risks in 2017 as the trading and retail sectors continue to weaken. Oxford Economics forecasts that unemployment will edge up slightly from 3.5 percent in 2016 to 3.6 percent in 2017, although this level is still considered as near-full employment.

Looking beyond 2017, economic growth could pick up as China re-emerges from its period of structural reform and the recovery in the US gains speed. In the longer term, the completion of massive new infrastructure works such as the Hong Kong-Zhuhai-Macau Bridge and the High Speed Rail (HSR) will provide new growth engines for Hong Kong.
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Establishing and Running a Business

- What are my options for investment?
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What are my options for investment?

Different entities that a foreign business can establish in Hong Kong

Hong Kong’s Companies Ordinance recognizes several types of companies:

- Limited Company
  - Company limited by shares, sub-divided into:
    - Private company
    - Public company
  - Company limited by guarantee without a share capital
- Unlimited Company with a share capital
  - Private company
  - Public company

Companies limited by guarantee do not have share capital, but the liability of its members is limited by the amount of assets they contribute. These entities are most commonly used as non-profits and NGOs.

An unlimited company is one where the liability of its members is not limited.

There are three differences between a public and a private company. For a private company:

- The ability for members to transfer shares is restricted.
- The number of members is limited to 50 (not including employees or former employees).
- The company may not issue invitations to the public to subscribe for shares or debentures of the company.

If a company does not meet the above three conditions, and is not a company limited by guarantee, then it is a public company. The establishment procedure for a public company is much more complicated than for a private one.

“"The establishment procedure for a public company is much more complicated than for a private one. As such, for most purposes the private unlimited company is the most popular option for foreign investors.""
Restrictions on foreign investment

Hong Kong does not subject foreign investments to special regulatory regimes or requirements per se. However, on the basis of public interest, there are restrictions on voting control by non-Hong Kong residents and corporations in the broadcasting sector. Such restrictions are set out in the Broadcasting Ordinance (Cap. 562) and the Telecommunications Ordinance (Cap. 106). The government’s special industrial-land policy features somewhat more complex rules, but it is still less demanding than the policies of many other Asian investment centers.

• **Television**

  The Broadcasting Ordinance states that foreign ownership of a Hong Kong company with a license to broadcast domestic free television requires written consent from the Broadcasting Authority at three thresholds:
  
  » Shareholding of 2-6 percent;
  » Shareholding of 6-10 percent; or,
  » Shareholding of over 10 percent.

  In addition, if foreign entities in aggregate hold over 49 percent of voting control in such a company, their votes shall be subject to a formula as outlined in the Broadcasting Ordinance.

  Companies with a license to broadcast domestic free television must be Hong Kong companies, and may not be the subsidiary of another company.

  These restrictions do not apply to paid television, or non-domestic television.

• **Radio**

  Foreign shareholding in a company with a sound-broadcasting license may not exceed 49 percent. Sound-broadcasting licenses can only be given to Hong Kong companies. Such companies may not be the subsidiary of another company.

**RELATED SERVICES**

Dezan Shira & Associates provides pre-investment market intelligence to foreign companies looking to establish a business in Hong Kong. For more information, please contact our experts at market.intelligence@dezshira.com
Requirements and steps to set up a company in Hong Kong

The registration of a company in Hong Kong usually starts with the creation of the company name and ends with the issue of a business registration certificate. During the whole process, there are mainly two government departments involved, namely the Companies Registry and Business Registration Office. The detailed procedures are set out below.

• **Step 1: Selecting a company name**

  The company’s name can be either in Chinese or English, or both. Investors can look up whether the desired name already exists in the Companies Registry. Also, the name may not infringe upon other parties’ intellectual property rights. This can be searched on the website of the Intellectual Property Department.

• **Step 2: Deciding the organizational structure, amount of capital, company secretary and registered office address**

  After selecting a company name, the investor should decide the member of the board of director of the intended company. If the first shareholder appoints anyone other than himself to act as director of the intended company, they should obtain a written consent from that person and at the same time obtain from that person a copy of their passport or identification card and a copy of residential address proof. It should be noted that since March 3, 2014, all companies registered in Hong Kong should appoint at least one natural person to act as its director. However, there are no restrictions on the nationality of the director.

  At the same time, the investor should determine the amount of capital and the number of shares to be issued to the first shareholder. The Companies Ordinance does not impose any restrictions on the minimum and maximum amounts of capital. It is the sole discretion of the investor to determine the amount of capital for the company based on the need of the operation and whether an extra license is required for the intended business activity. Since March 3, 2014, par values are not attached to shares. The Articles of Association (“AA”) should only state the number of shares and the amount of capital. The investor should contribute whatever amount stated in the AA immediately after the company is registered.

  The investor should also decide the company secretary and address of the registered office before registration. If there are two or more directors, one of the directors could act as company secretary. However, if the investor will be the sole director of the intended company, another person should be appointed to act as company secretary. A written consent to act as secretary should be obtained. The investor could also use the service of a professional firm, which provides nominee company secretary service with a fixed annual fee.
In respect of the address of the registered office, it should be located in Hong Kong. There is no particular limitation on the registered office except that a postal box number cannot be used as registered office of a Hong Kong company. If the founder does not plan to lease a physical office, he can utilize the service of a professional firm, as well.

**Step 3: Preparing registration documents and registering with the Companies Registry**

In this step, the investor should prepare the registration documents, including mainly the AA (signed by each founding member of the company) and Company Registration Form, and submit them to the Companies Registry for registration. At the same time, the investor should pay the company registration official filing fee and business registration fee. Investors can choose to register for one year and pay a fee of HK$250 or register for three years and pay a fee of HK$3,950 (prices effective since April 1, 2016). If the documents are prepared in accordance with the prevailing laws and regulations, the Companies Registry will issue the Certificate of Incorporation, which signifies that the company legally exists. Meanwhile, the Business Registration Office will also issue the Business Registration Certificate.

Generally, companies can be fully registered online, but investors can also file a paper company registration. Excluding the time needed to prepare the registration documents, the whole registration process will take one to five working days.

Note that some business activities may require an additional license, such as for import and export.

**Step 4: Making company chop and printing of Articles of Association**

After the company is officially incorporated, the investor should find a service provider to make the company chop and print the Articles of Association.

**Intellectual property**

Hong Kong offers a high level of protection for intellectual property (IP). According to the World Economic Forum, Hong Kong ranked 9th worldwide in terms of IP protection (2015-2016), and 13th according to the Intellectual Property Rights Index 2016. It is also a major global IP trading hub. Hong Kong recognizes several different classes of IP, including trademarks, patents, designs, copyright, trade secrets, plant variations, domain names and lay-out designs of integrated circuits.

**Registering a trademark**

Trademarks are registered with the Hong Kong Trademarks Registry. Registration only covers the territory of the Hong Kong SAR. Registration of a trademark in Hong Kong does not affect mainland China, and vice versa.
To register a trademark in Hong Kong, the investor should first investigate whether the trademark is already registered. This can be done online on the Trademark Online Search System (http://ipsearch.ipd.gov.hk/trademark/jsp/index.html). If the trademark is available, the investor can apply for registration by filling in a form, with a graphic representation of the trademark attached. Along with the fee of HK$2,000 plus HK$1,000 per each additional class of goods or services (if any), these documents should then be sent to the Hong Kong Intellectual Property Department (IPD).

The IPD will examine whether the trademark meets the requirements laid out in the Trade Marks Ordinance, including the following:

- The trademark needs to be distinctive;
- It cannot be a description of the goods or services the investor is providing or seeking to provide;
- It cannot be an industry or business term; and,
- The trademark has not been registered or applied for by another trader.

Provided that the application is complete and correct, the trademark registration can be completed in six months, upon which it will be published in the Hong Kong Intellectual Property Journal. If the IPD objects the registration, it will notify the investor in writing. The applicant will have six months to ratify the application. A further three months extension may be granted.

Registering a patent

Patents protect inventors by giving them the legal right to prevent others from manufacturing, using, selling or importing their patented invention.

Hong Kong has two types of patents: standard and short-term. Protection under standard patents is renewable annually after the end of the third year, for a maximum of 20 years. Protection under short-term patents is renewable after four years from filing, for a maximum term of eight years.

Applying for a patent elsewhere in the world or in other regions of China does not automatically give you protection in Hong Kong. Investors need to file an application with the Patents Registry of the IPD, which conducts only a formal examination of the patent paperwork. However, in order to be granted an effective patent in Hong Kong, the investor must have first registered the patent in one of three designated patent offices - the State Intellectual Property Office of the PRC, the European Patent Office or the United Kingdom Patent Office.

The application for a standard patent goes through two phases. The first phase is to file a request to record the existing patent (either from mainland China, the EU or the United Kingdom). This needs to be done within six months after the designated patent application. Within two months, the IPD will give the applicant notice of any issues with the application. If there are no issues, or if these have been corrected, the request will be published in the Hong Kong Intellectual Property Journal. The second phase is to file a request for registration and grant
of the Chinese, European or UK granted patent in Hong Kong, which should be conducted within six months after publication of the request to record, or the grant of the patent by the designated patent office.

The grant of a short-term patent is based on a search report from an international searching authority or one of three designated patent offices. The application for a short-term patent only needs to be submitted once and there is generally no time limit for filing. Within two months, the IPD will examine the application and give the applicant notice to correct any issues. If there is no issue or the issues are corrected, a short-term patent for the invention will be granted and published in the Hong Kong Intellectual Property Journal.

Registering a design

The Registered Design Ordinance defines designs as “features of shape, configuration, pattern or ornament applied to an article by any industrial process, being features which in the finished article appeal to and are judged by the eye”.

Designs can be registered and protected if the designer can show that they are new at the filing date of the application, or the priority date (if claimed). A design is new if it has not been previously registered, or has never before been published or disclosed. To file for the registration of a design, the applicant needs to submit the prescribed form, provide a representation and statement of novelty, and pay the registration fee. If the application is in order, the Designs Registry of IPD will publish the registration in the Hong Kong Intellectual Property Journal. The design will be protected for a maximum of 25 years, and needs to be renewed every five years.

Copyright

Unlike the other IP rights in Hong Kong, copyright arises automatically and does not need to be registered. It differs from design in that design protects the shape of an object. A copyright applies to the following:

- Literary, dramatic, musical or artistic work;
- Sound recordings, films, broadcasts or cable programs; and,
- The typographical arrangement of published editions.

With the copyright, the owner has the exclusive right to:

- Copy the work;
- Issue or make available copies of it to the public;
- Rent out copies of it to the public;
• Perform the work;
• Broadcast the work; and,
• Make an adaptation to the work.

Others are restricted from copying the work, which is defined as reproducing the work in any material form.

The protection for copyright differs from that of registered design in that copyright only protects against reproduction of the works, whereas a registered design also protects against the independent creation of a new design that is not substantially different from the registered design. The bar to prove a copyright infringement is also higher than for a registered design, in that for copyright infringement, the owner needs to show there is a reproduction in material form, whereas for registered design infringement, the designer needs to establish that the design is the same as or not substantially different from the registered design.

The owner of a copyright may seek a court injunction to prevent the reproduction and distribution of copyrighted materials, as well as claiming financial compensation.

Opening a bank account in Hong Kong

When a foreign investor wishes to set up a bank account in Hong Kong, the bank will usually require the directors and authorized signatories to come to the bank office in person for a Know Your Customer meeting. This is required under Hong Kong anti-money laundering legislation. Financial regulations have been tightened in recent years in order to combat the designation of the city as a tax haven.

As part of these regulations, the HKMA has released a Guideline requiring banking institutions to implement a background check on applications for business accounts. Specifically, the banking institution needs to verify the identity of the primary shareholders, at least two directors (including the managing director) and the authorized signatories.

These individuals will need to come in person to the meeting. Sending another individual on an absentee’s behalf is considered a red flag. The attendants of the meeting need to bring their passport (not a copy), their Hong Kong work permit (if applicable) and a proof of address. This can be a recent utility bill or something similar.

Under the Guideline, the bank is also required to examine the nature of the business. The bank will therefore commonly enquire about the intended use of the bank account, the company’s objectives (such as expected turnover), detailed information about operations (such as what products are being traded, the mark-up, etc.) its business scope and the source of funds. Often, the bank will request supporting documentation and review these in a process that may take between two to four weeks.

“ The legal representative is the person who really carries responsibility for a company in China. You will need to appoint someone who is not just technically competent, but China competent.”

FABIAN KNOPF
Senior Associate
International Business Advisory
Beijing Office

AN INTRODUCTION TO DOING BUSINESS IN HONG KONG 2017
Evidence of the nature of the business can include the company website, a business plan, proposed contracts, brochures, etc. If these are not available for the local company, information of this nature can be provided about the parent company or the corporate group instead. In any case, the applicants will need to submit:

- A copy of the Certificate of Incorporation and Business Registration Certificate;
- A copy of the company’s Articles of Association;
- A resolution of the board of directors to open an account, stating who is authorized to open and operate it; and,
- The company file at the Company Registry.

Please note that when a company is marked as a ‘shell company’, it will be subject to a higher level of scrutiny. Here, a shell company is understood to be a corporation that does not conduct business activities itself, but channels funds for group companies. To open a bank account for a shell company, the identity documents of the beneficial owners is required as well.

Once the bank account has been approved, the investor will receive the bank account number, bank cards and access codes. The account will become fully active once the first deposit has been made.

Recent trends

In recent years, Hong Kong has been blacklisted by many governments for being a haven for sheltering or laundering money, tax evasion and other criminal behavior. In order to rid itself of this status, the Hong Kong government has stepped up regulation of its banking and financial sector. This includes its acceptance of the Foreign Account Tax Compliance Act (FATCA). This American law intends to combat tax evasion committed by American citizens who hide their funds abroad by enlisting the cooperation of foreign governments. These governments then implement FATCA into their own law, establishing a regulatory framework that requires banks in that country to monitor all the transactions engaged in by American citizens. Since Hong Kong acceded to FATCA and implemented its stipulations into Hong Kong law, local banks are now required to set up a complex monitoring mechanism for American clients.

The costs of this mechanism have prompted many Hong Kong banks to refuse predominantly American clients – both corporate and individual – altogether. Even where Hong Kong banks still accept American clients, the compliance requirements have increased substantially, as has the red tape involved in opening accounts.
How do I make changes to my company?

Dormant company

A company can become dormant when it passes a special resolution (resolution approved by at least 75 percent of shareholders), and the Companies Registry has been notified.

If a company is dormant, many of its compliance requirements are reduced or lifted. The company no longer needs to:

- Hold annual meetings;
- Deliver annual returns*;
- Prepare financial statements and Directors' Reports;
- Appoint auditors and undergo annual audits;
- Publish financial statements to the shareholders before general meetings; or,
- Prepare summary financial reports.

A company returns from dormancy if the company passes a special resolution declaring that the company intends to enter into an accounting transaction and the resolution is delivered to the Registrar for registration; or there is an accounting transaction in relation to the company. Despite all the benefits, a dormant company still needs to maintain a registered office, corporate secretary and fulfil annual business registration.

Changing a company name

To change the company name, the board needs to pass a special resolution, though the resolution and the Articles of Association as altered need not be delivered to the Companies Registry. Instead, a “Notice of Change of Company Name” (Form NNC2) should be filled and delivered within 15 days after the passing of the Special Resolution together with the required fee (HK$295) either electronically through the “e-Registry” portal (www.eregistry.gov.hk) or in hard copy form to the Shroff on the 14th floor of the Queensway Government Offices. The change of name will be effective from the date on which the Certificate of Change of Name is issued. Please note that the intended company name should not be the same as a name appearing in the index of company names kept by the Companies Registry. In case the intended name change is rejected, the fee shall not be returned.

* However, a private company is still required to deliver an annual return for the year in which it declares itself to be dormant if the effective date on which the company becomes dormant falls after the 42nd day after the anniversary of its date of incorporation.
Changing the company’s Articles of Association

A company may alter most of its Articles of Association except:

• Articles on the liability of its members as stated in Section 83 and 84(1) of the Company Ordinance;
• Articles that are inconsistent with any rights attached to shares in a class of shares (for company with shared capital) or any rights of a class of members (for company without a share capital);
• Articles related to the contributions of members of a company limited by guarantee under section 84(2) of the Company Ordinance other than to increase the specified amount.

Under most circumstances, the alteration of the Articles of Association can only be done by passing a special resolution. However, an alteration in articles to the maximum number of shares that the company may issue may be made by ordinary resolution.

Within 15 days after the alteration is made, the following documents are required to be delivered for registration:

• A copy of the special resolution for alteration of the Articles of Association;
• A notice of alteration in the relevant specified forms, namely Forms NAA1, NAA2, NAA3 or NAA4;
• A certified copy of the Articles of Association as altered (for Forms NAA1, NAA2 and NAA3); and,
• Other relevant documents required to be delivered with the specified forms for registration as appropriate.

To be noted, the holders of at least five percent of the shares or five percent of the company’s members can appeal to the court to cancel an alteration of the objects of a company.

Deregistering the company

A private company or a company limited by guarantee, other than those companies specified in section 749(2) of the Companies Ordinance, may apply for deregistration when it is defunct. To do so, the following conditions need to be met:

• All shareholders agree to the deregistration;
• The company has not yet commenced operations or business, or has ceased operations or business during the three months before the application;
• The company has no outstanding liabilities;
• The company is not involved in any ongoing legal proceedings; and,
• The company or its subsidiary holds no assets consisting of any immovable property situated in Hong Kong.
Before the company can be deregistered, it first needs to obtain a “Notice of No Objection to a Company being Deregistered” (“Notice of No Objection”) from the Commissioner of Inland Revenue Department, the Hong Kong tax office. Directors and shareholders, or a person authorized by the company, can apply for such a letter. To apply for this letter, the applicant has to fill in a form, retrievable from the tax office website, and pay a prescribed fee. It takes up to 21 working days to process the request.

With the Notice of No Objection, the investor should then apply for deregistration with the Companies Registry within three months. To apply for deregistration, the investor has to fill in the designated form and pay a fee. The Notice of No Objection needs to be included in the submission. Where the applicant is a company, it must designate a natural person to give notice to the Companies Registry.

The deregistration will then be published in the Gazette on the website of the Government Logistics Department. If no objections are made in the following three months - such as by alleged creditors – then the deregistration is effectuated.

Former directors must keep the books and papers of the company for seven years after deregistration.

RELATED READINGS

How to Restructure an Underperforming Business in China
June, 2015

In this issue of China Briefing magazine, we explore the options that are available to foreign firms looking to restructure or close their operations in China. We begin with an overview of what restructuring an unprofitable business in China might entail, and then take an in-depth look at the way in which a foreign company can go about the restructuring process. Finally, we highlight some of the key HR concerns associated with restructuring a China business.
Tax, Audit and Accounting

- What are the major taxes in Hong Kong?
- Offshore status of Hong Kong companies
- Key compliance requirements
- Hong Kong’s double taxation agreement network
What are the major taxes in Hong Kong?

According to the Basic Law of Hong Kong, the taxation system of mainland China is not applicable to Hong Kong, which essentially means that Hong Kong enjoys an independent taxation system. Generally speaking, because the city only imposes three direct taxes, Hong Kong has one of the simplest tax economies in the world. There are also generous allowances and deductions to reduce the burden of taxpayers. Apart from direct taxes, certain indirect taxes are also collected, such as stamp duty and betting duty.

One thing to be noted is that Hong Kong doesn’t have any turnover taxes, including sales tax or value added tax, making it a favorable location for profit shifting and conducting re-invoicing activities. In this part of the guide, we first introduce the unique features of Hong Kong’s taxation system and then concentrate on its three direct taxes, which constitute a major part of the government’s fiscal revenue. Tax administration is charged by the Inland Revenue Department. The tax assessment year usually runs from April 1 to March 31 each year. A company may also choose its fiscal year at its own discretion.

Key features of Hong Kong’s taxation system

Compared to the taxation systems of other jurisdictions, Hong Kong’s tax system has some special features.

Firstly, taxes in Hong Kong are only levied on a territorial basis, unlike most countries which apply both residential jurisdiction and territorial jurisdiction in determining tax liability. That is to say, only income arising in or derived from Hong Kong is taxable, whereas worldwide income is not taxable, irrespective of the residence status of the taxpayers.

Secondly, there is no comprehensive system of income taxation in Hong Kong. Instead, a taxpayer is liable for tax on three different types of income. If an income fails to fall within any of the three specific tax provisions, then it shall not be subject to tax.

Salaries tax (individual income tax)

All individuals earning income arising in or derived from Hong Kong from an office, employment or pension are subject to salaries tax in Hong Kong. Tax payable is calculated at a progressive rate on the “net chargeable income” or at a standard rate on the “net income” (before deduction of the allowances), depending on which is lower. It is further reduced by the tax reduction, subject to a maximum.

\[
\text{NET CHARGEABLE INCOME} = \text{TOTAL INCOME} - \text{Deductions} - \text{Allowances}
\]

\[
\text{NET INCOME} = \text{TOTAL INCOME} - \text{Deductions}
\]
Tax rates

Progressive rates (year of assessment 2016/17 onwards)

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<thead>
<tr>
<th>Net chargeable income (HK$)</th>
<th>Rate</th>
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</thead>
<tbody>
<tr>
<td>On the first 40,000</td>
<td>2%</td>
<td>800</td>
</tr>
<tr>
<td>On the next 40,000</td>
<td>7%</td>
<td>2,800</td>
</tr>
<tr>
<td>On the next 40,000</td>
<td>12%</td>
<td>4,800</td>
</tr>
<tr>
<td>Remainder</td>
<td>17%</td>
<td></td>
</tr>
</tbody>
</table>

Standard rate of tax

15%

Allowance

Year of assessment 2016/17 onwards, in HK$

<table>
<thead>
<tr>
<th>Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic allowance</td>
</tr>
<tr>
<td>Marriage allowance</td>
</tr>
<tr>
<td>Child allowance (for each dependent): the 1st to 9th child</td>
</tr>
<tr>
<td>For each child born during the year, the child allowance will be increased by</td>
</tr>
<tr>
<td>Dependent brother or sister allowance (for each dependent)</td>
</tr>
<tr>
<td>Dependent parent and dependent grandparent allowance (for each dependent)</td>
</tr>
<tr>
<td>Parent/grandparent aged 60 or above or is eligible to claim an allowance</td>
</tr>
<tr>
<td>Parent/grandparent between the age of 55 to 60</td>
</tr>
<tr>
<td>Additional dependent and dependent grandparent allowance</td>
</tr>
<tr>
<td>Parent/grandparent aged 60 or above or is eligible to claim an allowance</td>
</tr>
<tr>
<td>Parent/grandparent between the age of 55 to 60</td>
</tr>
<tr>
<td>Single parent allowance</td>
</tr>
<tr>
<td>Disabled dependent allowance (for each dependent)</td>
</tr>
</tbody>
</table>
Deductions (maximum limits)

<table>
<thead>
<tr>
<th>Year of assessment 2016/17 onwards, in HK$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses of self-education</td>
</tr>
<tr>
<td>Elderly residential care expense</td>
</tr>
<tr>
<td>Home loan interest</td>
</tr>
<tr>
<td>Mandatory contribution to recognized retirement schemes</td>
</tr>
<tr>
<td>Approved charitable donations (income - allowable expenses - depreciation allowance) x percentage</td>
</tr>
</tbody>
</table>

Maximum tax reductions

Salaries tax for the year of assessment 2015/16 (the latest year for which data is available) is further reduced by the tax reduction of 75 percent, subject to a ceiling of HK$20,000 per case. For single taxpayers, the ceiling is applied to each individual; for couples jointly assessed, the ceiling is applied to each couple.

Profits tax (corporate income tax)

Any party, including corporations, partnerships, trustees and organizations involved in any trade, profession or business in Hong Kong, is subject to tax on all profits (excluding profits arising from the sale of capital assets).

Profits tax is levied based on assessable profits, which is determined by excluding deductions and tax-exempt incomes. It is further reduced by the tax reduction, subject to a maximum.

Profits tax rate

- Normal rate (for the year of assessment 2008/09 onwards)
  - Corporations: 16.5 percent
  - Unincorporated businesses: 15 percent

- Concessionary rate
  - Half of the normal profits tax rate is applied to trading profits and interest income received or derived from qualifying debt instruments issued in Hong Kong, and to offshore businesses of professional reinsurance companies
Exemptions

The following sums can be exempted from the assessable profits of a company:

• Dividends received from a corporation which is subject to Hong Kong profits tax;
• Amounts already included in the assessable profits of other persons chargeable to profits tax;
• Interest on Tax Reserve Certificates;
• Interest on, and any profit made in respect of, a bond issued under the Loans Ordinance (Cap. 61) or the Loans (Government Bonds) Ordinance (Cap. 64), or in respect of an Exchange Fund debt instrument or in respect of a Hong Kong dollar-denominated multilateral agency debt instrument;
• Interest income and trading profits derived from long term debt instruments; and
• Sums received or accrued in respect of a specified investment scheme by or to the person as:
  » A person chargeable to profits tax in respect of a mutual fund, unit trust or similar investment scheme that is authorized as a collective investment scheme under section 104 of the Securities and Futures Ordinance (Cap. 571); or
  » A person chargeable to profits tax in respect of a mutual fund, unit trust or similar investment scheme where the Commissioner is satisfied that the mutual fund, unit trust or investment scheme is a bona fide widely held investment scheme which complies with the requirements of a supervisory authority within an acceptable regulatory regime.

Deductions

• Deductible expenses

Generally, all outgoings and expenses, to the extent to which they have been incurred by the taxpayer in the production of chargeable profits, are allowed as deductions. However, the following items are non-deductible:

» Domestic or private expenses;
» Any loss or withdrawal of capital, the cost of improvements and any expenditure of a capital nature;
» Any sum recoverable under insurance or contract of indemnity;
» Rent of or expenses relating to premises not occupied or used for the purpose of producing the profits;
» Taxes payable under the Inland Revenue Ordinance, except salaries tax paid in respect of employees’ remuneration; and,
» Any remuneration or interest on capital or loans payable to section 16AA: contributions made to a mandatory provident fund scheme in respect of the proprietor or the proprietor’s spouse or, in case of a partnership, to its partners or their spouses.
• Expenditure on building refurbishment

  » A person who incurs capital expenditure on the renovation or refurbishment of business premises is allowed to deduct that expenditure over a period of five years in equal installments commencing the year in which the expenditure is made.

• Expenditure on plant and machinery specially related to manufacturing, and on computer hardware and software

  » For this kind of expenditure, a full deduction is allowed during the basis period in which the expenditure was incurred.

• Expenditure on environmental protection facilities

  » Expenditure on environmental protection machinery – With effect from the year of assessment 2008/09, a full deduction is allowed during the basis period in which the expenditure is incurred.
  » Expenditure on environmental protection installation – With effect from the year of assessment 2008/09, a deduction at 20 percent of the expenditure is allowed during the five years that follow the year in which the expenditure is incurred.
  » Expenditure on environmentally friendly vehicles – With effect from the year of assessment 2010/11, a full deduction is allowed during the basis period in which the expenditure is incurred.

• Depreciation allowances

  » Industrial building allowances on industrial buildings and structures
    » Initial allowance: 20 percent on the cost of construction of the premises
    » Annual allowance: four percent on the cost of construction of the premises
    » Balancing allowance or charge will be due upon disposal of the premises

  » Commercial buildings allowances on commercial buildings and structures
    » Annual allowance: four percent on the cost of construction of the premises
    » Balancing allowance or charge will be due upon disposal of the premises

  » Plant and machinery
    » Initial allowance: 60 percent on the cost
    » Annual allowance: at rates of 10 percent, 20 percent or 30 percent as prescribed by the Board of Inland Revenue in the Inland Revenue Rules, on the reducing value of the asset. Items qualifying for the same rate of annual allowance are grouped under one “pool”.
A balancing allowance is available only on cessation of a business to which there is no successor. A balancing charge can, however, arise wherever the disposal proceeds of one or more assets exceed the reducing value of the whole “pool” of assets to which the disposed items belong.

Donations

Charitable donations made to approved charitable institutions or trusts of a public character or to the Government of the Hong Kong SAR, amounting in aggregate not less than HK$100 but not exceeding 35 percent of the adjusted assessable profits before deduction of donations, are allowable for deduction in computing the assessable profits.

Maximum tax reductions

Profits tax for the year of assessment 2015/16 is further reduced by the tax reduction of 75 percent, subject to a ceiling of HK$20,000 per business.

Property tax

Property tax is levied on income arising from the letting of immovable property in Hong Kong, which is payable by the owner(s) at the standard rate of the year of assessment on “net assessable value” (NAV). Under the provisions of the Inland Revenue Ordinance, each and every joint owner or owner in common is responsible for reporting rental income on tax returns and paying property tax as if he/she is the sole owner.

Where the owner receives only rent and no other benefit, the annual rent is the “assessable value” (AV). Rent receivable (due but not yet received) should be included in the AV. Irrecoverable rent can be excluded from tax charge in the year in which it became irrecoverable. Any amount subsequently recovered is assessable to tax as income in the year of recovery.

The property tax is paid on 15 percent of the NAV.

- If the tenant pays rates, the NAV is equal to AV less than a standard allowance of 20 percent for repairs and outgoings.
- If the owner is responsible for paying rates, rates paid can be deducted before allowing for the 20 percent deduction.

A year of assessment runs from April 1 to March 31 of the following year.
A company in Hong Kong can be established without substance. This means that the business operation can be run in name only with no office or staff and can be operated remotely. Under the current practices, if no income is sourced from the Hong Kong company, meaning that all the income is sourced from abroad, then the company will not be liable for tax in Hong Kong. Generally, there are two common types of tests to determine a company’s offshore status:

**Contract effected test**

The contract effected test is used for determining the taxability of the income accruing to the taxpayer from trading transactions. The important factor here is whether or not the contract of purchase or sale is made in Hong Kong. This includes negotiation, conclusion and execution of the terms of the contract. The following factors should also be taken into consideration:

- How were the goods shipped?
- How were the sales solicited and orders processed?
- How were the goods procured and stored?
- How was financing arranged?
- How was the payment made?

**Operations test**

The operations test is for cases other than trading and money lending (manufacturing income and passive income). For commission income, when applying for tax exemptions, one should take the following questions into consideration:

- What is the originating cause of the income?
- Did the originating cause take place in Hong Kong?
- What has been done to earn profits and where was it done?

Essentially, enterprises should be aware of the following needs when applying for offshore status:

- No operations office in Hong Kong;
- No staff hired and working in Hong Kong;
- No customers/client from Hong Kong;
- No suppliers from Hong Kong;
- Income contract not negotiated or concluded in Hong Kong;
- Goods not entering Hong Kong;
- Services agreements or sales/purchases invoices should avoid involving any Hong Kong parties; and,
- The actual operations take place outside Hong Kong.
Once these basic requirements are met, the tax authority will check the supporting documents and decide whether the company should pay tax or not. However, once the exemption is granted the company should prepare annual accounting and audit reports, as well as tax returns in the jurisdictions where it operates outside of Hong Kong.

It is common for the tax authority to wait two to three years before questioning companies regarding their offshore status. At that point, the company should prepare for a review of their books starting from incorporation. Obtaining an offshore status was quite popular up to five years ago, but now the tax authority is becoming quite strict.

Documentary evidences including but not limited to the following documents are critical to the success of the claim:

- Organization chart with full details of the company’s establishments in Hong Kong and overseas which should include the location and size of the office, the number of employees and their respective names, post titles, duties and remuneration packages;

- Travelling schedule and passport of the directors and the persons who are involved in the business of the Hong Kong company;

- A detailed description of the businesses carried out by the company in order to earn income. For each of the activities identified, the company should specify the name of the responsible person and the place where such activity was performed;

- With regard to the income, especially high-income, the investor needs to provide the following documents:
  
  » Correspondence of negotiation with the customer and suppliers (email, fax, etc.);
  » Distribution agreement or master sales agreement should be provided (if any);
  » The purchase/sales order, sales confirmation, shipping documents and invoice of sales and purchase; and,
  » Relevant banking documents.
Accounting standards

As one of the two SARs of China, Hong Kong enjoys the rights to develop its own accounting standards, rather than applying the relative standards of mainland China. The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only organization authorized by law to promulgate financial reporting and auditing standards for professional accountants in Hong Kong.

The accounting standards of Hong Kong are known as the Hong Kong Financial Reporting Standards (HKFRS), which have been fully converged with International Financial Reporting Standards (IFRS) since January 1, 2005. According to the HKICPA, HKFRS are designed to apply to general purpose financial statements and other financial reporting of all profit-oriented entities.

On April 30, 2010, the HKICPA issued the Hong Kong Financial Reporting Standard for Private Entities (HKFRS for Private Entities) as a financial reporting option for private entities to relieve the reporting requirements under full HKFRS. Section 1 of HKFRS for Private Entities presents the qualifying criteria for applying this standard. However, entities are not mandated to adopt this standard, even if they are eligible to do so. This means that such eligible entities can apply for the full HKFRS if they wish.

There is an additional standard that applies to small and medium-sized entities, the Hong Kong Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRF & SME-FRS). This standard was initially issued in August 2005 and revised in March 2014. Again, the standard is not mandatory. The qualifying criteria is set out in Division 2 of the Hong Kong Company Ordinance and highlighted in Paragraphs 22-43 of this standard.

Bookkeeping requirements

According to Part 9 of the Hong Kong Companies Ordinance, the most recent version of which came into effect March 3, 2014, companies incorporated in Hong Kong must maintain proper books of accounts and must also satisfy statutory audit requirements on an annual basis.

Detailed requirements for bookkeeping are stipulated in the Subdivision 2 of the Company Ordinance, according to which:

- A company must keep accounting records that comply with:
  
  » Accounting records that are sufficient to show and explain the company’s transactions; to disclose the company’s financial position and performance with reasonable accuracy; and to enable directors to ensure that the financial statements comply with the Company Ordinance.
  
  » In particular, the accounting records must contain:
daily entries of all sums of money received and expended by the company, and the matters in respect of which the receipt and expenditure takes place; and,

the assets and liabilities of the company.

**Where to keep the accounting records:**

- A company’s accounting records must be open to inspection by the directors at all times.
- If a company’s accounting records are kept in a location outside Hong Kong, the accounts and returns must be sent to a place within Hong Kong. Those accounts and returns must disclose with reasonable accuracy the financial position of the business in question at intervals of not more than six months.

**How long accounting records are to be preserved:**

- The company must preserve the records for seven years after the end of the financial year to which the last entry was made.
- Penalties for not complying with the bookkeeping requirements: a director of a company who fails to take all reasonable steps to secure compliance with the bookkeeping requirements commits an offence and is liable to a fine of HK$300,000.

### Financial reporting requirements

Statutory reports are required annually for companies incorporated in Hong Kong. The reports must contain audited financial statements for the current year, with corresponding amounts for the preceding year, including a balance sheet, profit and loss account, and a cash flow statement. Audited financial statements must be prepared and signed off by a certified public accountant on behalf of a business or non-profit organization, to provide financial accountability and accuracy to a company’s stakeholders and people with a vested interest in the company.

Companies incorporated outside Hong Kong but have a place of business there should register as a foreign company with the Registry. If required to publish their financial statements under the laws or regulations of their incorporated place, the foreign company should file its financial statements in the annual return to the Registry.

Foreign companies whose securities are publicly traded in the Hong Kong Stock Exchange may prepare financial statements in accordance with either the HKFRS or the IFRS, or under certain limited conditions of other reporting frameworks, such as the China Accounting

*Section 51C of the Inland Revenue Ordinance provides a more specific list of the records to be kept*
Standards for Business Enterprises (ASBE) and Generally Accepted Accounting Principles in the United States of America (US GAAP).

To prepare financial statements, certain documents might be required according to the instructions by Inland Revenue Department. These are as follows:

<table>
<thead>
<tr>
<th>Type</th>
<th>Record to be maintained</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>Sales invoice</td>
</tr>
<tr>
<td></td>
<td>Goods return note</td>
</tr>
<tr>
<td></td>
<td>Receipt slip</td>
</tr>
<tr>
<td></td>
<td>Daily receipt record</td>
</tr>
<tr>
<td>Purchases</td>
<td>Purchases invoice</td>
</tr>
<tr>
<td></td>
<td>Petty cash voucher</td>
</tr>
<tr>
<td></td>
<td>Payment slip</td>
</tr>
<tr>
<td></td>
<td>Check stub</td>
</tr>
<tr>
<td></td>
<td>Statement</td>
</tr>
<tr>
<td>General expenses</td>
<td>Expenses invoice</td>
</tr>
<tr>
<td></td>
<td>Payment receipt</td>
</tr>
<tr>
<td></td>
<td>Check stub</td>
</tr>
<tr>
<td></td>
<td>Salary record</td>
</tr>
<tr>
<td>Bank transaction</td>
<td>Bank statements</td>
</tr>
<tr>
<td></td>
<td>Bank paid-in slip and related receipt details</td>
</tr>
<tr>
<td></td>
<td>Check stub and copy</td>
</tr>
<tr>
<td>Tangible assets</td>
<td>Purchase and sale agreement</td>
</tr>
<tr>
<td></td>
<td>Invoice and receipt</td>
</tr>
<tr>
<td></td>
<td>Check stub and copy</td>
</tr>
<tr>
<td>Inventory</td>
<td>Purchase and sale agreement</td>
</tr>
<tr>
<td></td>
<td>Invoice and receipt</td>
</tr>
<tr>
<td></td>
<td>Check stub and copy</td>
</tr>
<tr>
<td></td>
<td>Inventory list (including quantity and unit cost on every item)</td>
</tr>
<tr>
<td></td>
<td>Obsolete or slowing-moving inventory</td>
</tr>
<tr>
<td>Investment</td>
<td>Security ask/bid confirmation slip</td>
</tr>
<tr>
<td></td>
<td>Purchase and sale agreement</td>
</tr>
<tr>
<td></td>
<td>Capital inspection report (apply for PRC investment)</td>
</tr>
</tbody>
</table>
The benefits of Hong Kong’s DTAs for foreign companies

Double taxation arises when two or more tax jurisdictions overlap, resulting in the same item of income or profit being taxed in each. Hong Kong adopts the territoriality basis of taxation, whereby only income/profit sourced in Hong Kong is subject to tax, and that derived from a source outside Hong Kong by a local resident is in most cases not taxed in Hong Kong. Therefore, Hong Kong residents generally do not suffer from double taxation. Many countries which tax on a worldwide basis also provide their residents who operate a business in Hong Kong with unilateral tax credit relief. Hong Kong allows a deduction for foreign tax paid on a turnover basis in respect of an income which is also subject to tax in Hong Kong. Businesses operating in Hong Kong therefore do not generally have problems with double taxation of income.

Notwithstanding this, the Hong Kong SAR government recognizes that there are merits in concluding comprehensive double taxation agreements (DTAs) with their trading partners. A DTA provides certainty to investors on the taxing rights of the contracting parties; helps investors to better assess their potential tax liabilities on economic activities; and provides an added incentive for overseas companies to do business in Hong Kong, and likewise for Hong Kong companies doing business overseas. Up to now, Hong Kong has signed 35 comprehensive DTAs with other countries. In addition, Hong Kong is in the process of negotiating 14 comprehensive DTAs with other countries such as Germany, Finland and India.

Due to the international nature of aircraft operations, airline operators are more susceptible to double taxation than other taxpayers. As negotiation of a DTA may take a long time, it has been Hong Kong’s policy to include double taxation relief arrangements for airline income in the bilateral Air Services Agreements negotiated between Hong Kong and its aviation partners. Shipping income is another area of concern. Hong Kong is currently negotiating double taxation relief for shipping income with jurisdictions that either do not provide reciprocal tax exemption themselves or, even when reciprocal exemption provisions exist, prefer to employ bilateral agreements. There are also agreements that cover both airline and shipping income.

Hong Kong’s onshore-offshore tax regime often results in a reduced tax burden for those that operate through Hong Kong companies by pricing intra-group transactions. This has led to heightened transfer pricing scrutiny from the Hong Kong Inland Revenue Department in recent years. Consequently, the Advance Pricing Arrangement (APA) program* was introduced to Hong Kong in 2012, which was widely regarded as a welcome development for multinational companies, as it offers a non-adversarial approach in which taxpayers can engage with tax authorities in a transparent manner to achieve an optimal tax outcome. Importantly, Hong Kong can only start an APA program with another country after having signed a DTA with that country.

Hong Kong’s double taxation agreement network
## Hong Kong’s existing comprehensive DTAs

<table>
<thead>
<tr>
<th>Country / territory</th>
<th>Date of signature of agreement</th>
<th>Effective from</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>25.05.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
<tr>
<td>Austria (Protocol)</td>
<td>25.06.2012</td>
<td>03.07.2013</td>
</tr>
<tr>
<td>Brunei</td>
<td>20.03.2010</td>
<td>Year of assessment 2011/2012</td>
</tr>
<tr>
<td>Canada</td>
<td>11.11.2012</td>
<td>Year of assessment 2014/2015</td>
</tr>
<tr>
<td>Czech</td>
<td>06.06.2011</td>
<td>Year of assessment 2013/2014</td>
</tr>
<tr>
<td>France</td>
<td>21.10.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
<tr>
<td>Hungary</td>
<td>12.05.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
<tr>
<td>Indonesia</td>
<td>23.03.2010</td>
<td>Year of assessment 2013/2014</td>
</tr>
<tr>
<td>Ireland</td>
<td>22.06.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
<tr>
<td>Italy</td>
<td>14.01.2013</td>
<td>Year of assessment 2016/2017</td>
</tr>
<tr>
<td>Japan</td>
<td>09.11.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
<tr>
<td>Japan (Exchange of Notes)</td>
<td>10.12.2014</td>
<td>Year of assessment 2016/2017</td>
</tr>
<tr>
<td>Jersey</td>
<td>22.02.2012</td>
<td>Year of assessment 2014/2015</td>
</tr>
<tr>
<td>Korea</td>
<td>08.07.2014</td>
<td>Pending</td>
</tr>
<tr>
<td>Kuwait</td>
<td>13.05.2010</td>
<td>Year of assessment 2014/2015</td>
</tr>
<tr>
<td>Latvia</td>
<td>13.04.2016</td>
<td>Pending</td>
</tr>
<tr>
<td>Liechtenstein</td>
<td>12.08.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>02.11.2007</td>
<td>Year of assessment 2008/2009</td>
</tr>
<tr>
<td>Luxembourg (Protocol)</td>
<td>11.11.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
<tr>
<td>Country / territory</td>
<td>Date of signature of agreement</td>
<td>Effective from</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>--------------------------------</td>
<td>------------------------------</td>
</tr>
<tr>
<td>Mainland China (2nd Protocol)</td>
<td>30.01.2008</td>
<td>11.06.2008</td>
</tr>
<tr>
<td>Mainland China (3rd Protocol)</td>
<td>27.05.2010</td>
<td>20.12.2010</td>
</tr>
<tr>
<td>Mainland China (4th Protocol)</td>
<td>01.04.2015</td>
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</tr>
<tr>
<td>Malaysia</td>
<td>25.04.2012</td>
<td>Year of assessment 2013/2014</td>
</tr>
<tr>
<td>Malta</td>
<td>08.11.2011</td>
<td>Year of assessment 2013/2014</td>
</tr>
<tr>
<td>Mexico</td>
<td>18.06.2012</td>
<td>Year of assessment 2014/2015</td>
</tr>
<tr>
<td>Netherlands</td>
<td>22.03.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
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<td>New Zealand</td>
<td>01.12.2010</td>
<td>Year of assessment 2012/2013</td>
</tr>
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<td>Portugal</td>
<td>22.03.2011</td>
<td>Year of assessment 2013/2014</td>
</tr>
<tr>
<td>Qatar</td>
<td>13.05.2013</td>
<td>Year of assessment 2014/2015</td>
</tr>
<tr>
<td>Romania</td>
<td>18.11.2015</td>
<td>Income derived on or after 01.01.2017</td>
</tr>
<tr>
<td>Russia</td>
<td>18.01.2016</td>
<td>Year of assessment 2017/2018</td>
</tr>
<tr>
<td>Spain</td>
<td>01.04.2011</td>
<td>Year of assessment 2013/2014</td>
</tr>
<tr>
<td>Switzerland</td>
<td>04.10.2011</td>
<td>Year of assessment 2013/2014</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>11.12.2014</td>
<td>Pending</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>21.06.2010</td>
<td>Year of assessment 2011/2012</td>
</tr>
<tr>
<td>Vietnam (Protocol)</td>
<td>13.01.2014</td>
<td>Year of assessment 2016/2017</td>
</tr>
</tbody>
</table>
### Future DTAs under negotiation

<table>
<thead>
<tr>
<th>Country / territory</th>
<th>Negotiations scheduled</th>
<th>Scheduled negotiations completed on</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>22.08.2011 - 25.08.2011 (1st round)</td>
<td>25.08.2011</td>
</tr>
<tr>
<td></td>
<td>31.07.2014 - 01.08.2014 (2nd round)</td>
<td>01.08.2014</td>
</tr>
<tr>
<td>Finland</td>
<td>06.07.2010 - 08.07.2010 (1st round)</td>
<td>08.07.2010</td>
</tr>
<tr>
<td>Germany</td>
<td>16.06.2014 - 20.06.2014 (1st round)</td>
<td>20.06.2014</td>
</tr>
<tr>
<td></td>
<td>02.03.2015 - 06.03.2015 (2nd round)</td>
<td>06.03.2015</td>
</tr>
<tr>
<td>India</td>
<td>03.08.2010 - 05.08.2010 (1st round)</td>
<td>05.08.2010</td>
</tr>
<tr>
<td>Israel</td>
<td>20.01.2014 - 24.01.2014 (1st round)</td>
<td>23.01.2014</td>
</tr>
<tr>
<td>Macau SAR</td>
<td>05.07.2005 - 06.07.2005 (1st round)</td>
<td>06.07.2005</td>
</tr>
<tr>
<td></td>
<td>09.02.2007 (2nd round)</td>
<td>09.02.2007</td>
</tr>
<tr>
<td>Macedonia</td>
<td>09.06.2015 - 12.06.2015 (1st round)</td>
<td>12.06.2015</td>
</tr>
<tr>
<td>Mauritius</td>
<td>14.01.2013 - 17.01.2013 (1st round)</td>
<td>16.01.2013</td>
</tr>
<tr>
<td></td>
<td>15.01.2014 - 17.01.2014 (2nd round)</td>
<td>17.01.2014</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>25.05.2010 - 28.05.2010 (1st round)</td>
<td>28.05.2010</td>
</tr>
<tr>
<td></td>
<td>22.05.2011 - 25.05.2011 (2nd round)</td>
<td>25.05.2011</td>
</tr>
<tr>
<td></td>
<td>12.05.2015 - 14.05.2015 (3rd round)</td>
<td>13.05.2015</td>
</tr>
<tr>
<td>Turkey</td>
<td>10.08.2016 – 12.08.2016 (1st round)</td>
<td>12.08.2016</td>
</tr>
</tbody>
</table>
Human Resources and Payroll

- Employer’s obligations
- Visa requirements and procedures in Hong Kong
- Mandatory benefits
- Terminating an employee
Employer’s obligations

Unlike most countries, individual income tax, or salaries tax as it is known in Hong Kong, is not withheld by the employer. Instead, individuals need to pay their tax themselves.

As such, there are only two administrative requirements applicable to employers in Hong Kong.

Keeping payroll records

Employers need to keep records of the following information concerning their employees:

- Personal details
- Nature of employment: full time or part time
- Position
- Amount of cash remuneration, non-cash remuneration and other fringe benefits
- Contributions to the Mandatory Provident Fund or its equivalent
- Amendments to the terms of the employment contract
- Period of employment

The Inland Revenue Department needs to be informed of:

- Changes in the employee's particulars (change of residential address, marital status, etc.)
- Changes in the terms of employment
- The identity document number of the employee

Reporting remuneration paid to an employee

On April 1 every year, the Inland Revenue Department will issue a document called the Employer's Return to companies. Companies need to fill in and file these returns for:

- Unmarried individuals that are paid an annual income of HK$120,000 or more
- Married individuals
- Part time staff
- Directors

Employees are defined as:

- Persons employed by a Hong Kong company, including:
  - Part time and full time staff
  - Hong Kong and non-Hong Kong residents
  - Persons who provide services for the company in or outside Hong Kong
- Employees assigned or seconded to a Hong Kong company by its overseas holding company
When the company hires a new employee, it needs to inform the Inland Revenue Department within three months if the company anticipates that the employee is likely to be chargeable to salaries tax.

When an employee is terminated, the company needs to file the Employer’s Return one month before the date of termination.

When an employee leaves Hong Kong permanently or for a substantial period of time, the employer needs to:

- Ascertain from the employee their expected date of departure;
- File two copies of the Employer’s Return one month before the expected date of departure;
- Withhold all amounts due to be paid to the employee (including salaries, commission, bonus, reimbursement of rent/expense, money or money’s worth included) from the date of filing the Employer’s Return until the employee has made tax clearance and can produce to the employer a “letter of release” issued by the Inland Revenue Department.
Visa requirements and procedures in Hong Kong

Generally, a visa or entry permit is required to work, study, establish or join in any business or to take up residence in the HKSAR. Otherwise, there is high risk of being refused admission on arrival.

However, if an individual holds any of the following travel documents, no visa or entry permit shall be required for any purpose:

- Hong Kong Special Administrative Region Passport;
- British National (Overseas) Passport;
- Hong Kong Certificate of Identity;
- Hong Kong Re-entry permit (for entry from mainland of China and the Macau Special Administrative Region only);
- Hong Kong Seaman’s Identity Book;
- Hong Kong Document of Identity for Visa Purposes, provided that the document is valid or the holder’s limit of stay in Hong Kong has not expired;
- Travel documents bearing one of the following endorsements:
  » Holder’s eligibility for Hong Kong permanent identity card verified;
  » The holder of this travel document has the right to land in Hong Kong.
- Hong Kong Permanent Identity Card.

Visitor’s visa

Hong Kong grants a visa free period for citizens of most countries, usually for a length of 7, 14, 30 or 90 days depending on the country in question. Exceptions are for British nationals, who may stay in Hong Kong without visa for up to 180 days. To stay longer than the visa free period allowed, visitors must apply for a visa or entry permit before travelling to the HKSAR.

Visitors are required to have adequate funds to cover the duration of their stay without working and to hold onward or return tickets unless they are in transit to the mainland of China or the Macau SAR.

Visitors are not allowed to take up employment (paid or unpaid), to establish or join in any business or to enter school as a student, where other types of visa or entry permit might be applied.

Employment visa

Hong Kong has several different types of visa for employment and investment, including visa under the General Employment Policy (GEP), visa under the Admission Scheme for Mainland
Talents and Professionals (ASMTTP), visa under Immigration Arrangements for Non-local Graduates (IANG), visa under Admission Scheme for the Second Generation of Chinese Hong Kong Permanent Residents, and visa under Capital Investment Entrant Scheme (CIES).

Generally, the type of visa that is most applicable to foreign investors is the employment visa under the General Employment Policy. Other work visas are for entrepreneurs and semi-skilled workers, like technicians. Applicants for the employment visa must possess skills, knowledge or experience that are not readily available in Hong Kong. Note that different rules apply for mainland Chinese.

To apply for the employment visa, the following requirements must be fulfilled:

- The applicant has no record of a serious crime, nor poses a security risk;
- Good background, such as a degree in a relevant field, or technical qualifications, proven professional abilities or experience, backed by documentary evidence;
- The applicant has a confirmed job offer; and,
- Remuneration is broadly in line with market levels.

Apart from the application form, the following documents need to be submitted:

- From the employee:
  - Passport;
  - Copy of academic qualifications and relevant work experience; and,
  - Recent photo.

- From the employer:
  - The company’s employment contract or letter of appointment to the applicant containing information about post, salary, other fringe benefits and employment periods;
  - Photocopy of the Business Registration Certificate;
  - Photocopy of proof of financial standing, such as an audited financial report;
  - Documents with details of company background such as business activities; and,
  - Detailed business plan.

These documents need to be collected and delivered to the Immigration Department of Hong Kong SAR. Foreigners residing in mainland China at the time of application need to submit these documents to the Immigration Division of the Hong Kong Government in Beijing. The processing of the work visa application takes about two to three months.

If the visa application is granted, a permit label will be issued to the applicant, who has to affix it onto their passport. At this point, the fees need to be paid as well. With the label affixed onto the passport, the applicant can enter and work in Hong Kong.
Mandatory Benefits

Social Security

Pension

Employers and employees must contribute five percent of the employee's salary to a retirement scheme that is registered with the Mandatory Provident Fund, which was introduced on December 1, 2000. This scheme covers all employees aged over 18 and under 65 with exemptions. For both parties, the contribution amount is subject to the minimum and maximum relevant income levels. For a monthly-paid employee, the current minimum and maximum relevant income levels are HK$7,100 and HK$30,000 respectively. Please note that the figures may vary from year to year according to the government policy.

<table>
<thead>
<tr>
<th>Monthly relevant Income</th>
<th>Amount of mandatory contributions payable by employer</th>
<th>Amount of mandatory contributions payable by employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than HK$7,100</td>
<td>Relevant income x 5%</td>
<td>No contributions required</td>
</tr>
<tr>
<td>HK$7,100 to HK$30,000</td>
<td>Relevant income x 5%</td>
<td>Relevant income x 5%</td>
</tr>
<tr>
<td>More than HK$30,000</td>
<td>HK$1,500</td>
<td>HK$1,500</td>
</tr>
</tbody>
</table>

“Relevant income” refers to all monetary payments paid or payable by an employer to an employee, including wages, salary, leave pay, fees, commissions, bonuses, gratuities, perquisites or allowances, but excluding severance payments or long service payments under the Employment Ordinance.

Both employees and employers are free to make voluntary contributions in addition to mandatory contributions.

Employees can claim tax deductions for their contributions made to an MPF scheme, subject to the maximum amount of HK$18,000 for the year of assessment 2015/2016 and each subsequent year of assessment. However, any voluntary contributions made by employees are not tax deductible.

Employers can claim tax deductions for the mandatory and voluntary contributions made for their employees, to the extent that they do not exceed 15 percent of the employee's total remunerations.
Employee’s compensation

Under the Employee’s Compensation Ordinance, employers in Hong Kong are obliged to hold an employee’s compensation insurance policy to cover their liability to compensate employees for “injury by accident” or “death” arising during the normal course of their work, irrespective of the length of employment contract or working hours, full time or part time employment.

The amount of the liability which must be insured is determined by reference to the total number of the employer’s employees:

<table>
<thead>
<tr>
<th>Number of employees</th>
<th>Amount of the liability which must be insured per event</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not more than 200</td>
<td>Not less than HK$100 million</td>
</tr>
<tr>
<td>More than 200</td>
<td>Not less than HK$200 million</td>
</tr>
</tbody>
</table>

Note: The minimum amount of insurance cover is not the maximum liability that the party concerned is required to bear. The employer should therefore carefully assess the possible risk and consult insurers for professional advice on whether an insurance policy for an amount more than the minimum should be taken out.

An employer shall not make any deduction from the earnings of an employee in order to defray the cost of insuring against their liability to pay compensation.

Leave

Statutory holidays

All employees are entitled to leave on statutory holidays, irrespective of length of services. Hong Kong’s statutory holidays are as follows:

- New Year’s Day (January 1)
- First three days of Lunar New Year (late January or early February)
- Ching Ming Festival (April 4, 5 or 6)
- Labor Day (May 1)
- Dragon Boat Festival (in June)
- Establishment of the Hong Kong SAR (July 1)
- The day following Chinese Mid-autumn Festival (in September)
- Chung Yeung Festival (in September or October)
- Chinese National Day (October 1)
- Chinese Winter Solstice Festival (December 21 or 22) or Christmas (at the option of the employer)
An employee having been employed under a continuous contract for not less than three months is entitled to pay on statutory holidays.

An employer can ask an employee to work on statutory holidays. But the employer is required to give their employee at least 48 hours’ prior notice for work on a statutory holiday. The employer must then arrange an alternative holiday within 60 days before or after the statutory holiday. In this situation, an employer is advised to keep clear records of the alternative or substitute holiday taken by an employee. An employer must not make any form of payment to an employee in lieu of a statutory holiday.

Annual leave

Employees are entitled by law to a minimum of seven to 14 days paid annual leave, depending on their years of service with the company. The amount of annual leave owned by an employee is calculated as follows:

<table>
<thead>
<tr>
<th>Years of service</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9 or more</th>
</tr>
</thead>
<tbody>
<tr>
<td>Days leave</td>
<td>7</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td>11</td>
<td>12</td>
<td>13</td>
<td>14</td>
</tr>
</tbody>
</table>

Employers can determine when annual leave is to be taken and must give 14 days’ written notice to the employee of the time that they have selected. Annual leave must, however, be granted within 12 months of the end of the leave year, although in practice, most employers allow annual leave to be taken as it accrues.

Paid annual leave should be granted for an unbroken period, unless the employee requires so. Employees are entitled to take a payment in lieu of any accrued and untaken statutory annual leave from the previous leave year and are also entitled to payment in respect of any outstanding annual leave due upon cessation of employment. The law also permits employees to carry forward all untaken annual leave for 12 months after the preceding leave year.

The daily rate of annual leave pay is a sum equivalent to the average daily wages earned by an employee in the preceding 12-month period. If an employee is employed for less than 12 months, the calculation shall be based on the shorter period.

Sick leave

Employees may only take paid sick leave if they have accumulated enough paid sickness days. Paid sickness days are accumulated at the rate of two paid sickness days for each completed month of the employee’s employment during the first 12 months, and four paid sickness days...
for each completed month of employment thereafter, up to a maximum of 120 paid sickness days. Paid sickness days can be accumulated throughout the whole employment period.

The employee is not entitled to sickness allowance if:

- The employee refuses treatment without reasonable excuse;
- The sickness day falls on a statutory holiday; and,
- Compensation is payable by law (Employees' Compensation Ordinance).

During sickness leave, the employee's wage is reduced to 4/5 of the daily average wage as earned in the past 12 months.

Maternity leave

An employee who becomes pregnant must notify her employer. She is then entitled to:

- A continuous period of ten weeks' maternity leave;
- If childbirth occurs later than expected, added leave until the child is born; and,
- An additional leave of maximum four weeks for illness or disability due to the childbirth.

The employee may decide to take leave two to four weeks prior to the expected date of childbirth, with the agreement of the employer. In absence of such a decision, leave starts four weeks prior to birth. If childbirth occurs earlier than expected, that day is the starting day of the maternity leave. The employee is eligible for maternity leave pay if she has been working at least 40 weeks before the commencement of the maternity leave, and has given notice and produced a medical certificate with the expected date of birth. Maternity leave pay is set at 4/5 of the employee's regular pay over the past 12 months.
Terminating an employee

Types of termination

An employment contract in Hong Kong can be terminated in two ways: termination by notice, or immediate termination.

Immediate termination

The employer may terminate the contract without notice in case of:

• Willful disobedience of a lawful and reasonable order;
• Misconduct;
• Fraud or dishonesty; or,
• Habitual neglect of duties.

Besides, no notice is required during the first month of a probation period – if one is agreed upon.

The employee may terminate the contract without notice for:

• Reasonable fear of physical danger by violence or disease;
• Ill-treatment by the employer; or,
• Becoming permanently unfit for the type of work engaged in, as judged by a medical practitioner.

Termination with notice

An employment contract may be terminated by either side by giving the other party notice, or paying one month’s wages instead of notice. The default time within which to give notice is one month. Parties may contractually agree upon shorter notice, but no less than seven days.

The one month’s pay is calculated by taking the employee’s daily salary as earned over the past 12 months, and multiplying this by the number of days the wages would actually have been payable.

Termination prohibited

In five cases, an employee cannot be terminated:

• An employee who is confirmed to be pregnant and has submitted a pregnancy notice;
• An employee on paid sick leave;
• For reasons of giving evidence or information related to court proceedings, or an inquiry related to the enforcement of employment laws;
• For trade union membership or activities; or,
• An employee injured at work, without having first come to an agreement on compensation.
Severance payment

When an employee is dismissed, the employer needs to pay:

• Outstanding wages;
• Wages in lieu of notice, if applicable;
• Payment in lieu of untaken leave; and,
• Severance payment.

Employees who have worked for over 24 months with a company are entitled to severance payment. It is payable if the employee is dismissed by reason of redundancy, the contract is not renewed by reason of redundancy, or the employee is otherwise laid off.

Here, redundancy means that the employer either decided to close the business, the employer ceases to do business in that area, or the type of work the employee is involved in is expected to diminish or cease.

Lay off is a specific term that applies when the employee is hired under terms where remuneration depends on specific tasks that the employer provides. If during half of the total number of working days, in any consecutive four weeks, no work has been provided, this is a lay off. It is also a lay off if, in one-third of any 26 consecutive weeks, no work has been provided.

The severance payment should be calculated according to the following formula:

• For monthly-paid employee

\[
\text{SEVERANCE PAYMENT} = \frac{2}{3} \times \text{WAGES} \times \text{YEARS OF SERVICE}
\]

• For daily-rated/piece-rated employee

\[
\text{SEVERANCE PAYMENT} = \text{WAGES} \times \text{YEARS OF SERVICE}
\]

Service of an incomplete year should be calculated on a pro rata basis.

The total entitlement is subject to a maximum payment of HK$390,000.

* The sum should not exceed 2/3 of HK$22,500 (i.e. HK$15,000)
Long service payment

Employees who have been employed under a continuous contract for not less than five years are entitled to long service payment, if:

- The employee is terminated for reasons other than serious misconduct or redundancy;
- The contract expires and is not renewed;
- The employee dies (money goes to spouse, children or parents);
- The employee resigns for health reasons; or,
- The employee is aged above 65 and is retiring.

The amount of long service payment is calculated by reference to the same formula as for severance payment. The maximum entitlement shall not exceed HK$390,000. The amount of any contractual gratuity based on length of service is deductible from the amount of long service entitlement. In addition, that part of a retirement scheme payment which is due to the employer’s contributions may be deducted from the amount of long service payment.