



Newsletter Nr. 141 (EN)

**Short-Term Business Activity in Hong Kong
A Legal, Tax & Administration Guide**

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I. Introduction

Hong Kong is one of the few countries in the world which generates a budget surplus every year. The surplus for the 2013/2014 fiscal year is an estimated EUR 6.5 billion. In recent years, the Hong Kong government has tended to invest a significant part of this surplus into very large infrastructure projects, such as the expansion of the mass transit railway (“MTR”), the express train line to Shenzhen and Guangzhou and the Hong Kong-Zhuhai-Macau Bridge (due to be completed in 2016). As many local contractors are too small to meet the demands of such large projects, an increasing number of tenders have been submitted, and won, by foreign companies.

This newsletter has been drafted to give an overview of how a foreign company can conduct business in Hong Kong, particularly in regards to short term projects. This overview will include a review of the relevant labour, company and tax law.

Foreign companies can conduct business in Hong Kong as follows:

- Set up a Hong Kong company as a subsidiary or a sister company of the foreign company.
- Register a permanent establishment of the foreign company in Hong Kong.
- Set up a Joint Venture (“JV”) with a local partner-enterprise. There are two types of JV in Hong Kong:
 - Incorporated (or Equity) JV, whereby the JV is registered in the Hong Kong

- Companies Registry and a new corporate body is created.
- Contractual JV, whereby the cooperation between the parties is based on a contract without any registration. No new corporate body is created and the rights and liabilities of each JV partner remain separate.

II. Set up of a Hong Kong company

1. Set up of a Hong Kong company

The most popular corporate format in Hong Kong is a limited liability company. The setup costs are low and the procedure can be completed quickly. One director and one shareholder are required and both positions can be filled by the same person (natural person or corporate body). According to the new Companies Ordinance every limited liability company must have at least one natural person as director. A company secretary is also required. If the company has multiple directors then one of these can also act as the company secretary. However, the company secretary cannot be the same person as the company’s sole director.

The company can be registered via a postbox address, an actual physical office is not necessary. There is no minimum capital amount (theoretical 1 HKD possible, approx. 10 US cent) and there is no duty to pay up the share capital. Consequently, interest will not apply to non paid-up share capital. However, the shareholders are personally liable as debtors of the company for any unpaid amount.

The Articles of Association should be signed by all shareholders and submitted with the registration. Most Hong Kong companies use standard articles. A certification/notarization

of the Articles of Association or of the signatures is not required. The full registration process - from delivery of the documents to entry in the registry - takes four to seven workdays. The opening of a local bank account takes approx. seven workdays, if all documents are submitted properly.

German readers should note that according to § 138 Abs. 2 Nr. 1 AO the setup of a new company overseas must be reported to the finance authority.

2. Liquidation of a Hong Kong company

If a Hong Kong company has completed its project, it may be wound up and liquidated. This procedure is extensive and takes substantially longer than the original set up. For example, the liquidation of a small company usually takes 6 months. Liquidation is initiated by a shareholders' resolution. The Board of Directors is then recalled and a liquidator is appointed. The liquidator has all the powers and rights necessary to conduct the whole business of the company, including clearing and collecting debts.

The next step is for the liquidator to submit a closing balance sheet to the Companies Registry and the Inland Revenue Department and to pay all outstanding tax debts. All the company's other debts are then paid and any remaining capital is distributed to the shareholders. The liquidator reports the ending of the liquidation to the Companies Registry and the company will be deleted from the Companies Registry within 3 months.

3. Tax law treatment

A Hong Kong company's tax liability is based on Section 12 (1) Chapter 112 Inland Revenue Ordinance.

„(1) ...profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business ...”

For profits realised by commercial activities a “Profits Tax” is levied. According to the territorial principle, profits are only taxable when they are generated in Hong Kong (On Shore Profit). Profits are deemed to be generated in Hong Kong when the following 3 requirements are fulfilled:

- The tax payer undertakes business in Hong Kong.
- The profits arise from this business.
- The profits are generated in Hong Kong.

Assuming that the foreign company joins a Hong Kong project, then all profits resulting from this project are taxable in Hong Kong. However, if the profits are distributed to the European parent company, then they may be tax free in the foreign country too (e.g. Germany: non-deductibility of operating costs according to § 8b Abs. 5 KStG). The standard “Profits Tax” rate is 16.5%.

A Hong Kong company is legally obligated to keep books and to submit an annual balance sheet which is confirmed by a certified auditor. Hong Kong has a number of service companies (including the “Big Four”) that will keep these books on the company's behalf in exchange for a reasonable fee.

4. Summary

A Hong Kong company is a corporation entity which is similar to a German GmbH. It is a tax subject. A double taxation problem will not arise so long as the Hong Kong company does not have a registered office in Germany.

III. Set up of Joint Ventures

As noted above, business activities can be conducted in Hong Kong in co-operation with other companies via a JV.

1. Incorporated JV

An Incorporated JV (or Equity JV) is where at least two partners agree to set up a new corporation entity, the Joint Venture. Issues such as ownership structure, profit and loss sharing,



rights to vote and occupation of the positions etc can be negotiated freely between the partners/shareholders and then confirmed in writing via a Shareholder or Joint Venture Agreement.

Once the JV has been registered in the Companies Registry and at the Inland Revenue Department, it is a legally accepted Hong Kong company and it is treated the same as any other company. The company and the shareholders are subject to Hong Kong law.

All the JV partners will have limited liability like any other shareholder so long as their capital has been fully paid up. Profits generated by the JV can be distributed to JV partners as dividends. The partners are free to determine the profit participation in the Articles of Association. Usually, but not always, the profit participation will reflect partners' share ratio. The same applies to voting rights; thus the JV partner who invests the most can control who is appointed as a director etc and how key decisions are made.

2. Contractual JV

A Contractual JV is where the JV partners enter a contract to cooperate with one another for a stated purpose. No new company is established. For example, Partner 1 promises to produce cement, Partner 2 promises to use the cement for the agreed purpose of building a new bridge. As no new corporation entity has been created, the parties under a contractual JV are directly responsible and liable for the debts and other liabilities of the JV. In Germany such JVs are called "Arbeitsgemeinschaft" or ARGE. Normally ARGEs are used for mega projects like tunnels or road works.

In Hong Kong Contractual JVs must be registered with the Companies Registry. A contact address and person within Hong Kong must also be determined. As many local agency companies provide their address and a contact person for a small payment, this requirement is not a real problem. Each partner to a Contractual JV is individually liable for their own tax if

the project generates profits that are taxable according to Hong Kong tax regulations. Consequently, JV partners (for example a German GmbH) have to submit a tax declaration and pay Profit Tax (if applicable) in Hong Kong. In Germany the tax which has been paid in Hong Kong can be credited against the partner's German tax liability under § 26 Abs. 1, 2 KStG and § 34c EStG. However, investors should consider if it would be advantageous to create a JV with a company from Austria, Luxembourg or Switzerland rather than from Germany since such countries have full double taxation agreements with Hong Kong (Germany may have one in 2015).

IV. Permanent Establishment

It is also possible for a foreign enterprise to conduct business in Hong Kong via a branch rather than a new legal entity, since the branch is regarded as part of the mother company.

1. Registration

At the start of operations (i.e. immediately after or before starting work) the company has to register the branch with the Companies Registry. The foreign address of the parent company and the Hong Kong address of the branch must be announced and a representative of the company in Hong Kong must be named. Further, all directors and shareholders must be announced and an excerpt from the (German) commercial register must be obtained as proof of its valid existence. Moreover the company's (German) Articles of Association (translated) must be submitted to the Company Registry. As all the aforementioned (German) documents must be translated, the whole registration process can take several weeks, i.e. much longer than the set up process.

Finally, it should be noted that since branches are not corporation entities, they cannot be held directly liable for their actions and debts (like a Ltd. or GmbH). Instead the parent company will be held liable.



2. Tax law treatment

The branch should be registered with the Inland Revenue Department and must submit an audited balance sheet annually within 4 months after the tax assessment period has expired, even if the Inland Revenue Department does not explicitly request such a submission.

3. Problem of the double taxation

Expenses of the branch can be partly deducted as expenses of the parent company. However, the distinction is far from clear, and might cause more work than it brings benefits.

A branch in Hong Kong is tax liable. This creates problems, since profits must be ascertained separately for each branch. As an exact distinction is not possible, it has to be estimated which costs and income are apportioned by the branch and which are appropriated by the parent company. This bears the inherent risk of double taxation as the Hong Kong Inland Revenue Department and the foreign tax authorities are not bound by each other's judgments. Tax authorities on each side can decide freely on how much tax should be paid even if contradictions and double taxation are the result.

Therefore in order to avoid double taxation it is usually better to set up a company rather than a branch in Hong Kong. The company is then an independent tax subject and consequently is not liable for tax abroad. Considering Hong Kong's relatively low tax rate, a tax saving of up to 30% is possible.

V. Labour law

Every foreigner working in Hong Kong needs an Employment Visa from the first working day, no matter how long the working period and how much the remuneration is. The Employment Visa application is usually submitted by the employer (the "sponsor") who must be either a Hong Kong company or a natural person registered in Hong Kong. Thus both a Hong Kong subsidiary company and a branch can act as a sponsor. Certain

employee documents (curriculum vitae, certificates and proof of special skills) must be submitted along with an excerpt from the Companies Registry, balance sheet, business plan etc. All documents which are not in the Chinese or English language need be translated. If at the time of application the employer has not yet established a company or a branch then a Hong Kong business partner can submit the visa application and act as the sponsor. However, for time and cost reasons many local partners are unwilling to provide such assistance. Therefore, investors are advised to clarify in advance who must apply for such visas and who must bear the costs.

Once all the documents are submitted, the visa will be issued within 4 to 6 weeks. Most visas are valid for one year, although longer and shorter periods are possible

VI. Miscellaneous

1. Import and export

Hong Kong is a free harbour and on the whole does not levy any customs tariffs on imports and exports. Only 4 types of commodities are dutiable: Liquor, Tobacco, Hydrocarbon Oil and Methyl Alcohol.

An import/export declaration will be required for the transported goods and wares. The declaration procedure is straight forward and just involves stating the type of goods (listed in categories). The declaration costs amount to simply 0.5% of the goods' value.

2. Retention of title

In theory, Hong Kong allows for retention of title clauses to be included in commercial contracts. However in practice such clauses are not popular because of the common law tradition that the seller's right to payment does not out-rank the purchaser's right to the property.

Under retention of title clauses if a purchaser is unable to pay the amount owed (i.e. they are insolvent) the seller will be entitled to repossess the goods to the exclusion of other creditors.



However, under the law, where the sale is for specific goods which are already in a “deliverable state” the property in the goods passes to the buyer when the contract is made, unless a different intention appears (Section 20 Rule 1 Sale of Goods Ordinance, Chapter 26). For the sale of specific goods where the seller must do something to the goods to put them into a deliverable state, the property passes to the buyer when such task is completed (Section 20 Rule 2 - Rule 3, Sale of Goods Ordinance). Thus, according to the above mentioned rules, the property passes regardless of whether total payment has been made or not.

However, under Section 21 Sale of Goods Ordinance where the contract has a retention of title clause it can be considered that the property passes only upon a specific condition being fulfilled (i.e. payment). The condition must be formulated precisely. Further, the condition must be agreed and intended by both parties. Retention of title clauses for produced or manufactured goods or “all liabilities” clauses are also possible. Such clauses must be formulated

exactly and specifically, as any inaccuracy will be decided in favour of the purchaser. In most cases this means that the clause will be invalid, thus the seller will lose the property in the goods even if there is no payment received from the buyer.

VII. Conclusion

A company which wishes to conduct short term business activities in Hong Kong can either set up a new legal entity (Co. Ltd. or JV) or establishment branch office. In most cases the foundation of a Hong Kong company will be preferable as only this format can be used to avoid double taxation.

However, which business model is the best option will ultimately depend on the circumstances of each case. There is no general recommendation. A complete analysis regarding company and tax law is always required which includes a consideration of the interests of the parent company.

*We believe that the information provided was helpful for you.
If you have any further questions, please do not hesitate to contact:*

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