Taxation and Investment in Hong Kong 2011

Reach, relevance and reliability

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1.0 Investment climate

1.1 Business environment

Hong Kong is a Special Administrative Region (SAR) of the People's Republic of China. A mini-constitution grants the territory its own legislature, legal and judicial systems, and full economic autonomy. Beijing has responsibility for defense and foreign affairs. The Basic Law is the constitutional law of the Hong Kong SAR, which sets out the policies of the Chinese government towards Hong Kong and how the SAR is to be administered. Under the Basic Law, Hong Kong exercises executive, legislative and independent judicial power.

Hong Kong is primarily a trading center. It has virtually no natural resources and is therefore dependent on imports for raw materials, food and fuel. Hong Kong is a services center, in particular for companies (both foreign and those from Hong Kong) doing business in Mainland China.

Hong Kong participates independently in international trade and issues independent certificates of origin. It retains its border controls with China, its own customs procedures and the right to conduct international trade relations.

Hong Kong is a member in its own right of the World Trade Organization (WTO) and the Asia–Pacific Economic Co-operation (APEC) forum.

Hong Kong has concluded a Closer Economic Partnership Arrangement (CEPA) with Mainland China to facilitate access to Chinese markets for Hong Kong manufacturers and service-based companies. Under the CEPA, the mainland is committed to simplifying procedures and strengthening cooperation with Hong Kong on customs clearance, quarantine and inspection, quality assurance and food safety, and to facilitate investment. Nearly all goods produced in Hong Kong are able to enter the mainland at zero import tariffs. Overseas companies can take advantage of the CEPA's concessions granted to Hong Kong products and Hong Kong service companies by outsourcing to or partnering with a CEPA-qualified manufacturer or service company in Hong Kong.

Price controls

Hong Kong has no significant price controls apart from those on charges for public transport, electricity and some residential rents.

Intellectual property

The Hong Kong government is responsible for formulating its own intellectual property policies and enforcing intellectual property rights. Hong Kong conforms to the major intellectual property conventions, including the Trade-related Aspects of Intellectual Property agreements of the World Trade Organization. Hong Kong's intellectual property laws do not distinguish between residents of Hong Kong and foreign entities; a foreign corporation may arrange for coverage in Hong Kong and seek enforcement of its rights in the local courts.

The Copyright Ordinance Cap. 528 (enacted in 1997) and amendments thereto are the basis of Hong Kong copyright law, which is in line with prevailing international standards on copyright protection. It protects the following: computer software; drawings; literary, dramatic, musical, artistic works and performances; sound recordings, films and videos; and copyrighted works published on the Internet and in other digital environments. It also protects copyright owners against derogatory treatment of their works. Layout-design (Topography) of Integrated Circuits Ordinance Cap. 445, which protects the layout design of integrated circuits, took effect in 1994.

The copyright law provides for both criminal and civil remedies. To complement civil action by rights owners, Hong Kong imposes criminal sanctions on the manufacture, sale and distribution of pirated works and counterfeit goods. It is also considered an offence to be in possession of an infringing article for the purposes of trade or business in Hong Kong.

The Trade Marks Ordinance Cap. 559 2003, protects trademarks, as well as certification marks, collective marks and well-known trademarks. The law also specifies the period of non-use prior to revocation (three years) and the procedures for the registration of assignments and "registrable transactions" such as licenses. Trademarks must be registered before they are protected in Hong Kong.

The Patents Ordinance Cap. 514 (enacted in 1997) covers patents registered in Hong Kong. Standard patents have a term of 20 years. Short-term patents, with a term of protection of up to eight years, are also available. A subsequent amendment provides that a right of priority arising as a result of the filing of a patent application may be assigned or transmitted either together with the application or independently. This allows, for example, the owner of an invention who has filed a patent application in a Paris Convention country but who does not wish to seek patent protection in Hong Kong to assign their right of priority to another party to apply for a short-term patent in Hong Kong based on the same invention.

Enforcement of Hong Kong's intellectual property laws is under the jurisdiction of the Intellectual Property Investigation Bureau, which is part of the Customs and Excise Department.

Detention orders are another tool for intellectual property holders. These allow rights owners to seek Customs and Excise Department assistance in detaining suspected imports of pirated or counterfeit goods. The Copyright Ordinance allows courts to accept an affidavit as a basis of proof. Customs officials may seize and forfeit suspected pirated goods.

1.2 Currency

The currency in Hong Kong is the Hong Kong dollar (HKD).

1.3 Banking and financing

Hong Kong is a global banking center, hosting many of the world's largest banks. The strength of the banking sector is due to Hong Kong's expertise in trading currencies, foreign exchange and interest rate derivatives, interbank deposits and loans, private banking services and the arrangement of syndicated loans.

Hong Kong maintains a three-tiered system of deposit-taking institutions: licensed banks, restricted license banks and deposit-taking companies, collectively known as authorized institutions.

Only licensed banks may operate current and savings accounts and accept deposits of any size and maturity. Restricted license banks are only allowed to accept deposits of HKD 500,000 and above; deposit taking companies are only permitted to accept deposits of a minimum of HKD 100,000, with original maturity of not less than three months.

Banks are independent of the government, and foreign banks are free to operate with only limited restrictions.

1.4 Foreign investment

Hong Kong imposes almost no restrictions on foreign investment; foreigners can invest in any business and own up to 100% of the equity (except for state-owned activities and broadcasting and cable where foreign ownership may not exceed 49%).

There is no investment approval procedure directed specifically towards foreign investors, and Hong Kong's Basic Law safeguards "free movement of goods, intangible assets and capital". All businesses must comply with the registration requirements of the Companies Ordinance Cap. 32.

Hong Kong's high levels of inward and outward direct investment reflect its importance as a regional headquarters, business hub and international financial center. Mainland China continues to feature prominently in Hong Kong's external direct investment, both as a source and as a destination. This reflects Hong Kong's unique position as a gateway to the vast mainland markets, as well as a platform for mainland enterprises to access the global markets. This important strategic role has become more entrenched, along with the further expansion of economic cooperation and integration with the mainland, and with the Pearl River delta region in particular.

1.5 Tax incentives

Hong Kong does not offer targeted incentive regimes to overseas investors or foreign-owned firms. However, its free port status, low tax rates, good infrastructure, freedom from government interference and substantial available capital make it attractive to potential investors and thus competitive with other countries in the region. The simplicity of procedures for investing, expanding and establishing a local company is a major attraction for foreign investment in Hong Kong.

Nevertheless, the government does make certain tax facilities available. While capital expenditures are generally not deductible for Hong Kong tax purposes, to promote and direct capital expenditure towards specific areas, the government grants accelerated depreciation allowances on plant and machinery; and special deductions on expenditure (subject to specific deduction criteria) spent on R&D; payments for technical education; the purchase and sale of patent rights or rights to know-how, for use in Hong Kong in the production of chargeable profits; expenditure for building refurbishment; capital expenditure on the provision of prescribed fixed assets, including manufacturing machinery and computer hardware and software; capital expenditure on environmentally friendly vehicles. These special deductions, however, are not available to assets purchased under hire-purchase arrangements or assets leased to other persons.

Additionally, preferential profits tax treatment may be available, including a levy of only 50% of the profits tax rate or an exemption for certain qualifying debt instruments; qualifying reinsurance business and profits of offshore funds derived from specified transactions carried out by a nonresident.

1.6 Exchange controls

In line with its free market policies, Hong Kong imposes no controls on foreign exchange and there are no restrictions on foreign investment, i.e. no restrictions on the entry or repatriation of capital or on the conversion and remittance of profits and dividends derived from direct investments. Investors bring their capital into Hong Kong through the open exchange market and remit it in the same way.

Hong Kong has anti-money-laundering legislation allowing the tracing and confiscation of proceeds derived from drug-trafficking and organized crime. An anti-terrorism law allows the authorities to freeze funds and financial assets believed to belong to terrorists.

2.0 Setting up a business

2.1 Principal forms of business entity

The principal forms of business are the limited liability company (both private and public), branch or representative office, partnership and sole proprietorship. For an overseas company seeking to do business in association with a local firm, possibilities include a jointly owned company, a general or limited partnership or a contractual joint venture. Foreign investors in Hong Kong may use all available forms of business entity. Private limited companies and branch offices of foreign companies are the most frequently used forms.

Formalities for setting up a company

The Companies Ordinance Cap. 32 regulates both public and private limited companies. Unlike a public company, a private limited company may not issue bearer-share warrants or offer shares or debt instruments to the public, and share transfers are restricted. Most Hong Kong companies are private companies limited by shares. Foreign investors prefer the private limited form because it is easier to establish and has fewer onerous annual reporting requirements.

All businesses engaged in activities in Hong Kong, whether or not incorporated locally, must obtain a Business Registration Certificate from the Hong Kong tax authorities, the Inland Revenue Department (IRD), within one month of commencing business. Application is made by submitting a business registration form, together with payment of a fee, to the Business Registration Office at the IRD. The registration fee is HKD 450 for a one-year certificate and HKD 4,550 for a three-year certificate.

Additional licenses or consent are required for certain types of companies, such as banks or authorized institutions (regulated by the Banking Ordinance Cap.155), insurance companies (regulated by the Insurance Companies Ordinance Cap. 41) and securities dealers (regulated by the Securities and Futures Ordinance Cap. 571).

To be incorporated in Hong Kong, a new company must obtain a Certificate of Incorporation from the Companies Registry. Applications should be made within one month of the date of registration with the Companies Registry. An overseas company that commences business in Hong Kong before registration with the Companies Registry has been finalized may still apply for business registration within one month of the commencement of business.

As from 21 February 2011, the Companies Registry and the IRD jointly offer a one-stop company and business registration service to investors. An applicant that submits an incorporation form for a local company or an application form for registration of a non-Hong Kong company at the Companies Registry will be deemed to make a business registration application at the same time. Companies, therefore, only have to lodge a single application for both company and business registration. The one-stop company and business registration regime is not available for business registration by other types of businesses, such as sole proprietorships, partnerships and branches. In these cases, registration must be made directly with the Business Registration Office.

Forms of entity

Requirements for a limited company

Most companies are limited companies. A limited company generally has share capital and the shares carry a bundle of rights and obligations relating to the company. Limited liability means that the shareholder's personal liability to the company is limited to the par value of the shares, or to an amount guaranteed by the shareholder. If the company enters into a transaction with another party and incurs a debt to that party, the shareholders are not obligated to repay the debt, unless they specifically agree to do so.

Limited companies can be divided into private and public limited companies.

Capital. *Private company*: No minimum; no legal reserves required. Capital must be in cash, but cash may be used to procure franchises, plants, patents or know-how. There is no limit on the amount of authorized or issued share capital, and share capital may be in any currency. *Public company*: Same, except that in practice high paid-up capital must be listed on the exchanges.

Founders, shareholders. *Private company*: One founder or shareholder may form a private or public company, maximum 50 shareholders. No nationality or residence requirements. *Public company*: No nationality or residence requirements.

Board of directors/management. *Both forms*: No nationality or residence requirements except that the company secretary must ordinarily reside in Hong Kong (if an individual) or have a registered office in Hong Kong (if a corporation). One director may form a private company, but the individual is prohibited from also being the secretary of the firm.

Taxes and fees. For companies with share capital, the registration fee payable to the Companies Registry is HKD 1,720, including a levy, plus HKD 1 for every HKD 1,000 in nominal share capital, subject to a cap of HKD 30,000. For companies without share capital, the registration fee is HKD 170-HKD 1,025, depending on the number of members stated in the articles.

The fee payable to the Business Registration Office under the IRD for application of a Business Registration Certificate is HKD 450, including a levy for registration. Companies have the option of applying for a three-year business registration certificate, at a cost of HKD 4,550, with date of commencement of the certificate from 1 August 2009 to 31 July 2011.

Types of shares. *Private company*: All shares must be registered. Ordinary and preferred shares, with varying voting rights and dividend entitlements, are possible. *Public company*: Shares may be bearer or registered.

Control. *Private company*: Annual meetings must be held in each calendar year and balance sheets and profit and loss accounts presented. No more than 15 months can elapse between meetings. A majority of 51% suffices for most decisions, unless the corporate articles provide otherwise. *Public company*: Shareholders' meetings must be held once a year and details on the allotment of shares and receipts and payments on account of capital must be submitted.

Branch of a foreign corporation

A branch or representative office of a foreign company must register with the Registrar of Companies. Although a branch may conduct full business operations, a representative office may be set up only to collect information or maintain contacts with customers. A representative office normally is not liable for Hong Kong profits tax, but a branch office is subject to profits tax if it derives income from Hong Kong.

The following documents must be submitted to the Registrar of Companies when registering a branch or representative office: (1) a certified copy of the instrument defining the company's constitution (such as memorandum and articles of association, charter and statutes); (2) particulars of the company's directors and secretary and of the company's authorized representative in Hong Kong, including the addresses of the principal place of business in Hong Kong and the home country, and the registered office in the country of incorporation; (3) a certified copy of the certificate of incorporation or its equivalent in the company's home country; and (4) a certified copy of the latest audited accounts of the company's head office. The documents must be submitted together with an application fee of HKD 1,720 for registration of the documents.

A branch or representative office must file an annual return certifying that there have been no changes applicable to the documents filed under the original registration. It must also submit updated audited accounts (or have a solicitor or accountant file for an exemption from this requirement).

There may be advantages to choosing a branch over a local subsidiary, mainly under the home country's tax law. Unlike a subsidiary, a branch does not incur Hong Kong stamp duty on a transfer of the business which may involve the transfer of shares of a Hong Kong company, (except for land) and is not subject to an *ad valorem* incorporation fee. A branch does not require separate audits (those of the head office are acceptable). Setting up a branch entails fewer formalities and is usually less expensive. A branch may be able to depend on the credit of the head office, whereas this is not possible for a subsidiary.

Nonetheless, subsidiaries have benefits unavailable to branches. A subsidiary must file information only about itself; branches must file information about the overseas head office (such as accounts and directors' names). It is easier for the IRD to challenge the profits of a branch than those of a subsidiary, and the presence of a branch makes it easier for the head office to be sued in Hong Kong.

2.2 Regulation of business

Mergers and acquisitions

The Hong Kong Code on Takeovers and Mergers governs mergers and acquisitions (M&A), and the Companies Ordinance Cap. 32 and Transfer of Businesses (Protection of Creditors) Ordinance Cap. 49 contain relevant information about the sale or purchase of Hong Kong companies. Hong Kong does not have any general anti-competitive legislation or minimum domestic shareholding requirements. With the exception of restrictions specific to the banking, insurance and telecommunications sectors, M&A activity is largely unregulated.

Although Hong Kong does not tax capital gains or dividends, stamp duty is charged on the transfer of shares of Hong Kong companies and immovable property located in Hong Kong.

Monopolies and restraint of trade

Legal monopolies exist in the state-owned sector, transport services and utilities, partly because of the absence of antitrust laws. Many companies operate under franchises awarded by the government. Hong Kong has opened the telecommunications market to free competition, ending its local and international telephone monopolies.

2.3 Accounting, filing and auditing requirements

Every limited liability company in Hong Kong must appoint an auditor at its annual meeting. Only persons qualified under the Professional Accountants Ordinance (PAO) are recognized as company auditors. There are specific procedures for the appointment and resignation of auditors and penalties for corporate officers who make false statements to auditors.

There is no requirement that private companies file annual financial statements, but proper books of account must be kept and maintained at the company's registered office. Companies must file annual returns specifying directors, members and the location of a registered office.

Public companies must file annual accounts with the Companies Registry. Substantial shareholders, directors and chief executives must disclose all share transactions that increase their holdings to above 10% of total equity in the company, decrease their holdings to below 10% or change their holdings if their original total was above 10%. Directors, chief executives and their families must disclose all transactions to the exchange. All of these requirements must be met within five business days of the transaction concerned.

The Hong Kong Institute of Certified Public Accountants (HKICPA) is empowered by the PAO to develop and issue Financial Reporting Standards (HKFRS) and Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services (HKSA). These standards of accounting and auditing practices are required to be observed and applied by members of the HKICPA. In August 2005, the HKICPA released the Small and Medium-sized Entities (SMEs) Financial Reporting Framework and Financial Reporting Standard, effective for reporting periods starting on or after 1 January 2005, that better meet the needs of users of SME financial statements.

The HKFRS and HKSA have been developed to achieve convergence with International Financial Reporting Standards issued by the International Accounting Standards Board and the International Standards on Quality Control, Auditing, Assurance and Related Services issued by the International Auditing and Assurance Standards Board, respectively.

3.0 Business taxation

3.1 Overview

The Hong Kong system is territorial in nature, with tax levied on income arising in or derived from Hong Kong. Hong Kong has one of the least cumbersome tax regimes among developed economies and prides itself on its simple tax system and low rates. Profits from a Hong Kong trade or business are subject to a profits tax; income from employment or pensions is subject to a salaries tax; and income from property is subject to a property tax. Foreign-source income is not taxable even if remitted to Hong Kong.

Capital gains on transfers of capital assets are not taxed and no withholding tax is imposed on dividends paid out of profits after tax.

Hong Kong does not impose any direct payroll, turnover, value added, gift or capital gains taxes. Duties are charged on a few products, such as alcohol and tobacco.

3.2 Residence

Generally, a corporation (or other entity) is resident if it is incorporated in Hong Kong or managed and controlled in Hong Kong.

3.3 Taxable income and rates

Profits tax is levied on Hong Kong-source profits of businesses carried on in Hong Kong. Profits tax is levied at a rate of 16.5% (15% for unincorporated businesses) where the company is carrying on business in Hong Kong and the relevant income is earned in or derived from Hong Kong. No distinction is made between public and private companies or between distributed and undistributed profits. Branches of foreign companies are taxed at the same rates as local subsidiaries.

Taxable income defined

Corporations, partnerships, trustees and bodies of persons carrying on a trade, profession or business in Hong Kong are subject to tax on all profits (excluding offshore profits and profits arising from the sale of capital assets). If property is sold as part of a profit-making scheme, tax is due on any profits made. Assessable profit is the net profit for the basis period originating in Hong Kong, excluding offshore profits and profits arising from the sale of capital assets.

Income is considered sourced where the operation that generates it takes place. In determining the source of profits, Hong Kong generally adopts the operations test, which involves identifying the activities that are the most important in earning the profits and the place at which these activities are carried out. Thus, all profits arising in or derived from Hong Kong are taxable, except (1) offshore income from operations that are substantially conducted outside Hong Kong; (2) dividend receipts; and (3) capital gains. Interest—other than interest from bank deposits—accruing to a corporation conducting business in Hong Kong is subject to profits tax unless the credit is made available to the borrower outside Hong Kong.

Specified types of income from offshore funds managed outside Hong Kong are exempt from profits tax. In such a situation, a resident investor who holds an interest in the offshore fund may have its share of profits in the fund subject to tax in Hong Kong under a deeming provision if certain conditions are satisfied.

Special formulas apply in calculating taxable profits for airline, shipping and insurance businesses.

In addition to the above, income from the following is subject to profits tax:

- Fees from the exhibition or use in Hong Kong of cinema, television, film or tape, or any sound recording;
- Grants, subsidies or similar financial assistance connected with a business conducted in Hong Kong;

- Fees received for rental of movable property in Hong Kong;
- Royalties from the use of, or the right to use, certain types of intellectual property in Hong Kong; and
- Royalties from the use of or right to use certain types of intellectual property outside Hong Kong, but such royalties may be deductible as expenses of the payer in determining the latter's taxable profits.

Partnerships are treated as taxable entities in Hong Kong, and profits distributed to partners are not taxable. Profits or losses shared by individual partners in the partnership are taxable or deductible to the partner under personal assessment if he/she has elected for that (and provided the partner is eligible for the election).

Deductions

Expenses are generally deductible to the extent they are incurred in the production of profits that are chargeable to tax. Deductible items include interest on borrowed funds that meets certain criteria, rent for buildings or land occupied, bad and doubtful debts incurred, depreciation (subject to certain limits), repairs to plant and premises, costs of implements used to produce taxable profits, fees to register trademarks or patents, costs to purchase patent or trademark rights, R&D expenses, payments for technical education (subject to certain rules), contributions to employee retirement schemes (limited to 15% of an employee's compensation during the relevant tax period) and approved charitable donations (limited to 35% of assessable profits).

If a company's profits are derived from both Hong Kong and non-Hong Kong sources that are not assessable to profits tax, the expenses attributable to the non-Hong Kong-source profits are not deductible and are added back to increase assessable profit.

No deduction is allowed for interest paid to a non-financial institution if the recipient is not subject to tax in Hong Kong on the interest. In addition, no deduction is allowed for interest payments arising from a loan that is secured by another loan or bank deposit of the borrower or its associates except when the interest from the other loan or bank deposit is subject to tax in Hong Kong. Nor is a deduction permitted for interest where there is an arrangement under which the interest will be paid, directly or through an interposed person, back to the borrower or its associate, unless the recipient is subject to tax in Hong Kong on the interest.

Depreciation

For capital expenditure incurred on the construction of industrial buildings and structures, the initial depreciation allowance is 20% of the capital expenditure, taken in the year of the expenditure. An additional 4% of the capital expenditure is allowed annually thereafter, until the total expenditure is written off. The annual depreciation allowance for commercial buildings that do not qualify as "industrial buildings" is 4% of the cost of construction.

If the building (either industrial or commercial) is disposed of, a balancing allowance or charge equal to the difference between the disposal price and the written-down value on the disposal may arise.

Capital expenditure on the renovation or refurbishment of business premises may be deducted over five years in equal installments, starting in the year the expenditure was incurred.

Expenditure on plant and machinery especially related to manufacturing, and on computer hardware and software, may be written off in the year the expenditure is incurred, except for assets purchased under hire-purchase arrangements or assets leased to other persons.

For other plant and machinery, the initial depreciation allowance is 60% in the year the expenditure is incurred. Thereafter, IRD prescribed rates of annual depreciation (of 10%, 20% or 30%) apply to the declining balance. Items qualifying for the same rates of annual allowance are grouped into "pools." For plant and machinery not specified by the IRD, the usual rate is 20%.

A balancing allowance is only available on the cessation of a business when the disposal proceeds of the assets are below the reducing value of the whole "pool" of assets. A balancing charge may arise, however, if the disposal proceeds of one or more assets exceed the reducing value of the whole "pool" of assets to which the disposed items belong.

Assets may be re-valued upwards, but tax depreciation is based on cost.

Losses

Losses attributable to carrying on a business that earns profits subject to profits tax may be carried forward indefinitely and set off against future taxable profits of the company. There is specific anti-avoidance legislation to prevent the purchase of an unrelated loss company for the sole or dominant purpose of obtaining a tax benefit.

3.4 Capital gains taxation

Although there is no capital gains tax in Hong Kong, net gains on certain transactions deemed speculative might be liable for profits tax as trading income.

3.5 Double taxation relief

Unilateral relief

Businesses operating in Hong Kong rarely have problems with double taxation of income. Hong Kong's territorial source basis of taxation means that income derived by a resident from outside Hong Kong will generally not face double taxation. The IRD allows a deduction for foreign tax paid on income subject to tax in Hong Kong if such foreign tax is paid on the gross amount of the income, regardless of whether a profit is derived.

Tax treaties

Hong Kong has tax treaties in force with Austria, Belgium, Brunei, China, Hungary, Ireland, Luxembourg, Thailand, United Kingdom and Vietnam, but has concluded treaties with a number of other countries. Where there is a double tax agreement, foreign tax paid may be credited against profits tax on the same profits, but the credit is limited to the amount of Hong Kong tax payable on the same income.

Hong Kong has agreed to adopt the exchange of information standards set by the OECD.

The IRD has not issued any guidelines on the procedure to apply treaty benefits, so it is unclear whether treaty benefits can be applied directly or whether advance application is required (except for guidance in respect of a residence certificate for application of the tax arrangement with China). In the absence of guidance, if a taxpayer after reviewing the factual situation is satisfied that a particular treaty applies, it may file a claim in the tax return for the IRD's review.

3.6 Anti-avoidance rules

Transfer pricing

There is no specific transfer pricing provision governing transactions between two resident companies that are associated with one another. However, a general anti-avoidance rule may be used by the Hong Kong IRD to challenge any unreasonable non-arm's length transaction. The Hong Kong IRD issued a practice note on transfer pricing in December 2009, specifying that in general Hong Kong follows OECD methodologies. According to a rule governing transactions between a resident and a closely connected nonresident, when transactions between such parties result in no profits or less-than-normal profits to the resident, the nonresident will be deemed to be carrying on business in Hong Kong and its profits may be subject to tax in Hong Kong.

Thin capitalization

There are no thin capitalization rules in Hong Kong. However, deduction of interest expenses may be affected by anti-avoidance provisions.

Controlled foreign companies

Hong Kong does not have CFC legislation.

General anti-avoidance rule

General anti-avoidance provisions are contained in Hong Kong's tax legislation, i.e. the Inland Revenue Ordinance (IRO). The rules may be invoked for any deliberate attempt to implement tax avoidance schemes through the use of artificial and fictitious transactions; the implementation of transactions with the sole or dominant purpose of producing a tax benefit; or the use of tax loss companies. In addition, there are provisions and measures to target other tax avoidance schemes with regard to transfer pricing arrangements and the use of service companies specifically.

Since the IRO contains general anti-avoidance provisions, the application of case law principles on anti-avoidance (e.g. the "Ramsay" or "Furniss v Dawson" principles) is very limited. In the context of stamp duty, however, the IRD may apply these common law anti-avoidance principles against tax avoidance schemes to minimize stamp duty.

3.7 Administration

Tax year

The tax year starts on 1 April of every year and ends on 31 March the following year. For businesses, the basis period of tax computation is the accounting year ended in the tax year.

Filing and payment

Tax returns are issued annually on 1 April for companies to report their profits in the accounting year ended in the previous tax year. Upon receipt of the tax return, assessments are raised. At the same time, companies are required to pay a provisional profits tax for the current tax year at a rate of 16.5% of the previous fiscal year's profits. This payment is used to offset against the final profits tax, which is payable in the following fiscal year on final assessment. Any excess payment is applied to the provisional profits tax payable for the following year.

If the provisional tax charged is considered excessive, an application may be made no later than 28 days before the due date or 14 days after the date of the issue of the assessment, whichever is later, to have all or part of the provisional tax collection held over.

Consolidated returns

Hong Kong does not allow groups of companies to file consolidated returns (nor are there provisions allowing group loss relief for members of a group of companies).

Statute of limitations

The general statute of limitations is six years, which may be extended to 10 years in the case of fraud or willful evasion. An assessment or additional assessment (as a result of any adjustments) may be made only within six years (where no fraud or evasion applies) after the relevant year of assessment. There are no provisions governing the time limit for the collection of tax.

Tax authorities

The IRD is the main tax authority in Hong Kong. It is headed by the Commissioner of Inland Revenue (CIR), who also holds the office of Collector of Stamp Revenue. The IRD is one of nine departments under the administration of the Financial Services and the Treasury Bureau. The IRD is responsible for the administration of various Ordinances, as well as the rules and regulations made under these Ordinances. Relevant ordinances include Betting Duty Ordinance Cap.108; Inland Revenue Ordinance Cap.112; Stamp Duty Ordinance Cap.117; Tax Reserve Certificates Ordinance Cap. 289; Business Registration Ordinance Cap. 310; and the Hotel Accommodation Tax Ordinance Cap. 348.

The Commissioner's Office comprises the CIR and two Deputy CIRs that are responsible for the overall administration and operations of the IRD. The duties are divided among six different units, namely, Commissioner's Unit; Headquarters Unit; and Units 1-4. Apart from the Commissioner's Unit, each is headed by an Assistant CIR. The Commissioner's Unit is responsible for appeals, technical research, tax treaties, etc. The Headquarters Unit is mainly responsible for training, enquiry services and tax records. Unit 3 is primarily responsible for tax collection, stamp duty and business registration, while Unit 4 specializes in field audits and investigations. Tax processing and review works of property tax, salaries and profits tax are spread across the Headquarters Unit, Unit 1 and Unit 2.

Rulings

The IRD formalized its advance ruling service in 1998 in order to provide taxpayers with a degree of certainty, promote consistency in the application of the tax laws, rules and regulations, and minimize disputes with taxpayers.

Any person may apply to the CIR for a ruling on how a provision(s) of the Inland Revenue Ordinance applies to the taxpayer or the arrangement specified in the application. The scope of a ruling covers the application of the territorial source principle for profits tax purposes; service companies, stock borrowing and lending transaction, royalty payments, the general anti-avoidance provision and sale of loss companies. A fee must be paid for a ruling request and certain formalities must be observed.

3.8 Other taxes on business

There are no notable additional taxes on business.

4.0 Withholding taxes

4.1 Dividends

Hong Kong does not levy withholding tax on dividends.

4.2 Interest

Hong Kong does not levy withholding tax on interest.

4.3 Royalties

Royalty payments made to a nonresident for the use of, or the right to use, intangibles in Hong Kong, or where the royalty payments are deductible for the payer, are deemed to be taxable in Hong Kong. The amount deemed taxable is 30% of the gross amount of the royalties paid, resulting in an effective rate of 4.95% (4.5% for a non-corporate person). If a royalty is paid to an affiliated nonresident and the intangibles were owned by a person carrying on business in Hong Kong, 100% of the royalty is deemed to be taxable, resulting in an effective rate of 16.5% (15% for a non-corporate person). The payer of royalties to a nonresident is required to withhold the appropriate tax and remit that amount to the Hong Kong IRD.

4.4 Branch remittance tax

Hong Kong does not levy a branch remittance tax.

4.5 Wage tax/social security contributions

There is no payroll tax in Hong Kong.

For employees whose monthly income is HKD 5,000 or more, the employer is required to deduct 5% as the employee's contribution to the Mandatory Provident Fund (MPF) scheme and then pay an additional 5% as its own contribution.

5.0 Indirect taxes

5.1 Value added tax

Hong Kong does not levy a VAT or Goods and Services Tax.

5.2 Capital tax

Capital duty is levied at 0.1% of an increase in the authorized share capital (subject to a cap of HKD 30,000).

5.3 Real estate tax

Property owners are taxed on rental income derived from property in Hong Kong. The tax is charged at a standard rate of 15% of the net assessable value of the property as determined by rent, service charges and fees paid to the owner, less a statutory allowance of 20% on the net assessable value for repairs and maintenance. If a company includes income from property in its income subject to profits tax, it may deduct the amount of property tax paid from the amount of profits tax due.

5.4 Transfer tax

See under Stamp duty.

5.5 Stamp duty

Stamp duties are charged on documents connected with the lease, sale or transfer of immovable property in Hong Kong, and the sale of shares. If the above are transferred at less than market value, stamp duty may be imposed based on the market value at the date of transfer. The rate on the lease of immovable property is 0.25% of the total rent payable for a short-term lease (one year or less), 0.5% of the annual or average annual rent for a one- to three-year lease and 1% of the annual or average annual rent for a lease exceeding three years.

The maximum duty on the sale and conveyance of property is 4.25% of the value of property transferred. The stamp duty on the transfer of Hong Kong shares is 0.2% of the value of the shares transferred.

The government has proposed the introduction of a Special Stamp Duty (SSD) on the disposal of residential property, on top of the current ad valorem stamp duty. Any residential property acquired on or after 20 November 2010 and resold within 24 months will be subject to the proposed SSD. The proposed measure still must be enacted.

5.6 Customs and excise duties

Hong Kong does not levy customs duties. The only excise taxes are levied on alcoholic beverages, tobacco, methyl alcohol and hydrocarbon oil.

5.7 Environmental taxes

None

5.8 Other taxes

Other levies include a duty on bets (25%-75%) and the Air Passenger Departure Tax, levied on all air passengers departing Hong Kong at HKD 120 per person (12 years and above).

6.0 Taxes on individuals

The Hong Kong personal income tax (salaries tax) covers all income arising in or derived from Hong Kong from an office, employment or pension. Hong Kong taxes only business profits, employment income and property rental income arising in or derived from Hong Kong. Interest income earned by an individual, without carrying on a business in Hong Kong, is exempt from tax in Hong Kong.

Personal income tax in Hong Kong remains low compared with rates in other Asian countries, with a top marginal tax rate of 17%. Taxes on the salaries of foreign executives usually rise to the ceiling rate of 15%. Tax rates are progressive, but a ceiling applies to the overall tax liability. Permanent and temporary residents may obtain relief from the standard rate of 15% tax on profits and income by electing to be assessed under personal assessment. An election may offer relief when the tax calculated under personal assessment is less than the aggregate amount of the tax charged separately under profits tax, salaries tax and property tax.

6.1 Residence

Hong Kong uses the territorial source principle of taxation. The Inland Revenue Ordinance does not provide a definition of residence, but a specific reference is made to a residence requirement for the purpose of personal assessment for individual taxpayers.

6.2 Taxable income and rates

Any person, including locally employed individuals and expatriates who derive Hong Kong-source employment income are subject to salaries tax. A person who visits Hong Kong for not more than 60 days in a tax year (from 1 April to 31 March of the following year) is not liable to salaries tax on his/her employment income.

An employee who was employed locally and who has already paid tax of substantially the same nature as Hong Kong salaries tax in any territory outside Hong Kong is exempt in respect of income derived from services rendered in that territory outside Hong Kong.

Taxable income

Individuals are taxed on their total Hong Kong income from employment, less deductible expenses, charitable donations and personal allowances.

The source of employment income is determined by where the contract was negotiated and concluded and where enforceable; the residence of the employer; and where the salary is paid. Income from non-Hong Kong employment is deemed to be sourced in Hong Kong if it is attributable to services rendered in Hong Kong. Directors' fees paid to directors of a company, the control and management of which is exercised in Hong Kong, are chargeable to salaries tax irrespective of where the director resides. Pensions are taxable if the funds are managed and controlled in Hong Kong and if the pension (other than government pensions) relates to services rendered in Hong Kong.

Taxable income includes commissions, bonuses, awards, gratuities, allowances (including those for education) and other perquisites derived from employment. The taxable (or rateable, if lower) value of a rent-free residence provided by an employer or its associates is presumed to be 10% of the employee's salary (4% or 8% for hotel and hostel accommodations depending on the number of rooms). This beneficial treatment also applies to reimbursement of the rent paid for accommodation of the employee. Dividend income is not taxed, but gains from exercising share options are taxable. Education benefits for the children of employees are taxable.

Unemployment compensation is not taxable. Severance payments and long-term service payments that must be paid under the Employment Ordinance are not subject to salaries tax. Any payment exceeding the amount calculated under the Employment Ordinance may be subject to salaries tax.

If both spouses have employment income and live together, they may choose to file a joint or separate assessment. If a couple files separately, all child allowances may only be claimed by either parent.

Tax is not withheld from salaries, but employees who have been in Hong Kong for more than one year may have to pay provisional payments during the year of assessment, based on the amount of their chargeable income in the preceding year.

Deductions and reliefs

Donations exceeding HKD 100 to approved charities may be deducted up to a maximum of 35% of assessable income minus other deductions. Business deductions, including expenses incurred for travel and entertainment, are allowable if they are wholly, exclusively and necessarily incurred to produce income subject to salaries tax. Self-education expenses of up to HKD 60,000 may be deducted, as may home loan interest up to HKD 100,000 and elderly residential care expenses of up to HKD 72,000 (for the year of assessment 2011/12, subject to the enactment of the proposed legislation). Contributions to the Mandatory Provident Fund (MPF) scheme or the Recognized Occupational Retirement Scheme also are deductible up to HKD 12,000 per annum.

Major personal income tax allowances for tax year 2011/12, are as follows: HKD 108,000 for a single person; HKD 216,000 for a married couple; HKD 108,000 for single parents and HKD 30,000 for siblings. There are proposed changes to these personal allowances for 2011/12, also subject to the enactment of the proposed legislation, that include HKD 60,000 for each of the first nine dependent children with an additional allowance of HKD 60,000 for each child born during the year; and HKD 36,000 for a dependent parent or grandparent (aged 60 or above) and HKD 36,000 for additional dependent parents or grandparents living with the taxpayer; and HKD 18,000 for a dependent parent or grandparent (aged between 55-59) and HKD 18,000 for additional dependent parents or grandparents living with the taxpayer.

Rates

Personal income is taxed in Hong Kong at progressive rates. The marginal tax rates range from 2% to 17% (on chargeable income less personal allowances), with a cap at the standard rate of 15% (on assessable income, i.e. chargeable income without deduction of personal allowances).

6.3 Inheritance and gift tax

The estate tax has been abolished.

6.4 Net wealth tax

Hong Kong does not levy a net wealth tax.

6.5 Real property tax

Property owners are taxed on rental income derived from property in Hong Kong. The tax is charged at the standard rate of 15% of the net assessable value of the property as determined by rent, service charges and fees paid to the owner, less a statutory allowance of 20% on the assessable value for repairs and maintenance

6.6 Social security contributions

For employees whose monthly income is HKD 5,000 or more, the employer is required to deduct 5% as the employee's contribution to the MPF scheme and then pay an additional 5% as its own contribution. Self-employed persons also contribute 5% of their relevant income and may choose to contribute on a monthly or annual basis. The maximum deduction is HKD 1,000 per month. All benefits derived from mandatory contributions must be preserved until the scheme member attains the retirement age of 65, when the member may withdraw the benefits in a lump sum.

6.7 Other taxes

None

6.8 Compliance

The tax year starts on 1 April of every year and ends on 31 March of the following year. The IRD issues tax returns to individual taxpayers on the first working day of May each year.

7.0 Labor environment

7.1 Employee rights and remuneration

Conditions of employment in Hong Kong are governed by the Employment Ordinance Cap. 57. The terms of the ordinance apply to workers under a "continuous contract" (i.e. employees who have worked for an employer for four weeks or more, for at least 18 hours each week). Unless explicitly agreed to the contrary, a continuous contract is deemed to be a contract of one month's duration, renewable monthly.

Full-time employment of individuals younger than age 15 is prohibited, while persons aged 15-18 may not work more than eight hours per day. The Occupational Safety and Health Ordinance Cap. 509 provides for the safety and health protection of employees in both industrial and non-industrial workplaces. The commissioner for labor is empowered to issue improvement notices and suspension notices against workplace activities that might create hazards to the employee. Failure to comply with improvement or suspension notices constitutes an offence punishable by fine and imprisonment.

The Employees' Compensation Ordinance Cap. 282 establishes a no fault, non-contributory employee-compensation system for work injuries. The Factories and Industrial Undertakings Ordinance provides safety and health protection to workers in the industrial sector.

Working hours

Effective 1 May 2011, the Minimum Wage Ordinance came into effect, setting the initial statutory minimum wage rate at HKD 28 per hour.

There are no statutory restrictions on overtime hours in industry for men or women older than age 18. Overtime is not allowed for workers younger than age 18. Children younger than age 15 are prohibited from full-time industrial employment, and young persons are not permitted to work in industry at night or below ground level or to work more than 10 hours a day.

7.2 Wages and benefits

Under the Employment Ordinance Cap. 57, employers are required to pay wages on time; failure to comply may result in fines and imprisonment for three years.

Mandatory fringe benefits for all factory workers include one rest day per calendar week and 12 paid statutory holidays per year. Under the Employment Ordinance Cap. 57, annual leave entitlement depends on length of employment. Paid annual leave ranges from seven days for employees with a minimum of one year of service to 14 days for employees with more than nine years of service. Other mandatory fringe benefits include 24 days of paid sick leave for the first year, then 48 days for each additional year, with no more than an accumulated 120 consecutive days total; severance pay for lower paid workers; and long service payments.

Pensions and social insurance

The MPF provides a formal and compulsory system of retirement protection. With certain exceptions, members of the workforce aged between 18 and 65, as well as self-employed persons aged 65 or below, are required to participate and make regular contributions. Members of the scheme include full- and part-time employees who have been employed for 60 days or more under an employment contract and self-employed persons.

There are three types of MPF schemes: a "master trust scheme" (open to employees of more than one employer, self-employed individuals and those with accrued benefits transferred from another scheme); an "employer-sponsored scheme" (open only to employees of a single employer and its affiliates); and an "industry scheme" (for employees in industries with high labor mobility, such as catering and construction).

For employees whose monthly income is HKD 5,000 or more, the employer is required to deduct 5% as the employee's contribution to the MPF scheme and then pay an additional 5% as its own contribution. Self-employed persons also contribute 5% of their relevant income and may choose to contribute on a monthly or annual basis. The maximum deduction is HKD 1,000 per month. All benefits derived from mandatory contributions must be preserved until the scheme member attains the retirement age of 65, when the member may withdraw the benefits in a lump sum.

Employee compensation

The Employees' Compensation Ordinance Cap. 282 establishes compulsory employer-paid insurance for employee death or injury at work, including injuries suffered while commuting in employer-provided transport. The policy must cover full liabilities for compensation under the ordinance and common law damages.

Other benefits

An employee is eligible for maternity leave pay if she has worked under a continuous contract for not fewer than 40 weeks before the leave, has properly given notice and has produced a medical certificate specifying the expected date of confinement, if so required by her employer. Paid maternity leave should be at least ten weeks at four-fifths of normal salary.

Many workers receive additional benefits such as free medical treatment, subsidized meals, a good attendance bonus and subsidized transport to and from work. Some companies also provide free or subsidized accommodation for their workers. Fringe benefits may add 15-20% to base pay.

Many firms voluntarily grant more generous benefits than those described above. In addition to Sundays, there are about 17 general holidays per year, which are granted with full pay to employees of banks and commercial organizations. Larger industrial undertakings offer 12-18 holidays per year during traditional Chinese festivals. An "end-of-year payment" or "13th-month bonus" is often included as a term of the employment contract for permanent and monthly rated workers.

7.3 Termination of employment

Under the Employment Ordinance Cap. 57, notice is required from either party unless there is just cause for dismissal. Wages may be paid in lieu of notice. The amount of notice varies from 7-14 days for unskilled and skilled labor to one month or more for professional and managerial staff.

The Ordinance imposes limits on termination. If a female employee is eligible for maternity leave and has completed 12 weeks of service with an employer, termination is not allowed during the period from the date on which she gives notice of her intention to take maternity leave until the date on which she is due to return to work. Termination is not allowed during the period an employee is on paid sick leave. An employer may not dismiss an employee on the grounds that he/she has given evidence or information to the appropriate authorities in connection with an accident arising out of and in the course of employment, the enforcement of the Employment Ordinance or breach of work-safety regulations. In addition, termination of employment is not permitted for trade union membership and activities, and employees injured at work may not be dismissed until a compensation agreement has been reached.

The Employment Ordinance Cap. 57 requires an employer to grant severance pay to a worker who has been employed continuously for 24 months and is dismissed because of redundancy or is laid off. A worker is considered to have been laid off if the employer has not provided work for more than one-half the total number of normal working days in any period of four consecutive weeks or if the non-provision of work exceeds one-third of the total number of normal working days in any period of 26 consecutive weeks. The severance payment, which must be made before dismissal, is 18 days' wages or two-thirds of the worker's pay during the previous month, subject to a maximum of HKD 15,000 for every year of service.

The Employment Ordinance Cap. 57 also requires employers to make long service payments to employees who have worked continuously for the same employer for five years and who are being dismissed for reasons other than summary dismissal or redundancy. Payment should also be made to employees who resign because of ill health or old age (usually age 65 or older) and to families of eligible employees who die in service. The payments vary by years of service and are calculated in the same way as those for severance payments.

An employer may summarily dismiss an employee without notice, or payment in lieu of notice, if the employee (1) willfully disobeys a lawful and reasonable order, (2) is guilty of misconduct, (3) is guilty of fraud or dishonesty, or (4) is habitually neglectful in his/her duties.

7.4 Labor-management relations

Hong Kong enjoys smooth labor relations. Although trade unions command respect in management circles, strikes are rare and are usually resolved quickly and quietly.

The government's commissioner for labor is advised by the Labor Advisory Board (LAB), which comprises six employer representatives and six employee representatives.

Workers in Hong Kong are free to join trade unions. Trade unions are registered under the Trade Unions Ordinance Cap. 332, which is administered by the Registrar of Trade Unions (part of the Labor Department). Registered trade unions are corporate bodies and enjoy immunity from certain civil suits. The vast majority of Hong Kong's workforce is not unionized.

Labor contracts are rare in Hong Kong, although employers must inform new employees of the conditions of employment. There is neither national nor industry-by-industry collective bargaining.

The Labor Relations Ordinance Cap. 55 provides extra means for settling disputes that cannot be resolved through ordinary conciliation. These means include special negotiation, voluntary arbitration and boards of enquiry.

The Minor Employment Claims Adjudication Board (MECAB) resolves minor employment claims quickly, simply and inexpensively. A claim that cannot be resolved amicably through conciliation may be referred to the MECAB, which is empowered to adjudicate employment claims involving not more than ten claimants for up to HKD 8,000 per claimant. The Labor Tribunal within the judiciary hears employment claims falling outside the jurisdiction of the MECAB. Hearings of minor employment claims are conducted in public and no legal representation is allowed. However, the MECAB's award or order is legally binding.

Hong Kong's Labor Tribunal, which is part of the judiciary, provides a quick way to adjudicate employer-employee disputes; it usually handles individual monetary claims arising from employment contracts.

7.5 Employment of foreigners

Hong Kong requires that local workers be given priority in filling job vacancies available in the job market. Employers must register the relevant job vacancies at the Labor Department for a specified period. Imported workers are to be paid at least the median monthly wages of comparable local workers under standard contracts governed by all labor laws in Hong Kong. On completing their employment contracts, they must return to their places of origin. Employers found to have violated the labor laws in Hong Kong are liable for prosecution.

An employment visa is granted provided an applicant takes up employment only in the business or activity applied for. However, the applicant's dependants are allowed to accept employment and are entitled to receive education in Hong Kong.

To attract mainland Chinese talent, the Hong Kong government has implemented the Admission Scheme for Mainland Talents and Professionals. Under the scheme, employers that are registered companies in Hong Kong may apply to bring in talent and professionals from mainland China. The employing company must demonstrate that the purpose of the application is to meet the firm's operational or research needs. There must be a confirmed offer of employment with a reasonable remuneration package, including income, accommodation, medical and other fringe benefits broadly commensurate with the prevailing market level for professionals in the relevant field in Hong Kong. The candidate should be employed in a job relevant to that person's academic qualifications, professional abilities and working experience, and one that cannot be readily taken up by the local workforce. This is a quota-free and non-sector-specific scheme.

8.0 Deloitte International Tax Source

Professionals of the member firms of Deloitte Touche Tohmatsu Limited have created the Deloitte International Tax Source (DITS), an online resource that assists multinational companies in operating globally, placing up-to-date worldwide tax rates and other crucial tax material within easy reach 24/7.

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9.0 Office locations

To find out how our professionals can help you in your part of the world, please contact us at the office listed below or through the “contact us” button on http://www.deloitte.com/tax.

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