

Legal Aspects of Doing Business in Hong Kong

A publication specially produced for the business seminar
HOW TO PROFIT IN HONG KONG AND CANADA
presented by

Hong Kong Economic & Trade Office
in association with

Hong Kong Canada Business Association & Hong Kong Trade Development Council

June 1994

Concept & Design: **AMPNetwork**

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Aside from the advantage of being the western world's "Gateway to China", Hong Kong's laissez-fair economy, its low corporate and individual tax rates together with its skilled labour force make it an excellent place to set up a wide variety of businesses. In order to fully benefit from Hong Kong, Canadian business people should obtain the advice of legal and accounting professionals so that their business may be set up in the form most suited to their operations. This booklet will give Canadian business people an overview of the legalities of doing business in Hong Kong.

Forms of Foreign Business Entities in Hong Kong

The variety of entities used to conduct business in Hong Kong will be very familiar to Canadian business people. Among the most common forms of business entities are:

- (1) sole proprietorships;
- (2) subsidiaries;
- (3) branch operations; and
- (4) partnerships.

Most Canadian corporations carry on business in Hong Kong by way of a branch operation or by incorporation of a local subsidiary. Both a branch and a subsidiary have the same power to acquire, hold and dispose of immovable property in Hong Kong and the start-up costs and local tax rates on profits are also similar. Therefore, a Canadian corporation's decision as to the type of entity to be used to carry on business in Hong Kong will be based upon its global tax issues, or its corporate liability or administrative considerations rather than the actual cost of doing business there.

Branch Operation

If a Canadian corporation sets up a branch operation in Hong Kong, the Canadian corporation will be deemed by Hong Kong authorities, to be carrying on business in Hong Kong. As a result, the branch will be required to comply with all administrative requirements of the Colony.

The following are some aspects of branch operations in Hong Kong:

- (a) while the branch will be deemed by Hong Kong authorities to be carrying on business in Hong Kong, Canadian taxation authorities will require that profits from the Hong Kong operation be included in the Canadian corporation's global profits and will tax these profits at the applicable Canadian tax rates. However, any operating losses will be deductible against the global income of the Canadian corporation;

(b) since the branch is not a Hong Kong corporation, Hong Kong company law requirements will not be imposed on the branch or the Canadian corporation. In general, company law requirements in Canada are more liberal than those found in Hong Kong; for example, a Hong Kong company can only reduce its capital with court approval, it may only purchase its own shares under certain limited conditions, there are limitations on loans to directors, and there are limitations on the types of indemnities that can be given to the directors of Hong Kong companies;

(c) in general, Hong Kong stamp duties are not exigible on the transfer of the branch to another corporation. However stamp duty is exigible on the transfer of land or the transfer of shares in Hong Kong companies owned by the branch; and

(d) there is no lengthy liquidation process in the event that the branch is liquidated.

Establishing a branch of a Canadian corporation in Hong Kong is relatively easy. The branch must be registered with the Hong Kong Registrar of Companies and the Commissioner of Inland Revenue within one month of establishing a place of business in Hong Kong. An entity which is acting only as a representative or liaison office for a Canadian corporation need only be registered with the Registrar of Companies. Generally, a representative office may not create any legal obligations between the parent company and another entity. Therefore, it is important that legal advice be obtained prior to setting up a representative office so that its activities may be closely examined to ensure that the activities carried on by such an office do not bring it within the requirements to make a full registration as a branch.

Registration of a branch or representative office in Hong Kong is generally obtained approximately three to four weeks from the date of filing all necessary documentation together with a filing fee of HK\$2,000. A business registration certificate granted to a branch or representative office is valid for a one year period and must be visibly displayed at the branch or representative office.

Many Canadian corporations obtain a branch registration prior to the establishment of business premises in Hong Kong. Such prior registration facilitates the leasing of premises, expedites any visa applications for employees coming from Canada and also helps facilitate the opening of bank accounts. Many banks and landlords will not do business with a corporation which has not been registered in Hong Kong.

The branch will usually be able to register in Hong Kong with the same name as the Canadian corporation. However, the Registrar may direct that the branch change its name within six months of registration if it finds that the name is identical or similar to the name of an existing Hong Kong company or branch, or, if the name is likely to mislead the public. A branch is also required to conspicuously exhibit its name, the country of its incorporation and the fact that the foreign corporation is a limited liability company on its letterhead and in its business premises in the Colony.

Upon the establishment of a branch, certain corporate accounts and returns must be filed with the Registrar on an annual basis to notify the Registrar of changes within the Canadian corporation's corporate operations; for example, amendments to its articles or by-laws, changes in its corporate name, or changes of directors.

Closing down and ceasing the operations of a Hong Kong branch are also very simple. A Notice of Cessation of Business must be sent to the Registrar and the Commissioner. Any outstanding taxes or returns will have to be finalized and forwarded to the relevant authorities. The parent Canadian corporation must appoint an authorized representative in Hong Kong for period of three years after the Notice of Cessation is filed to accept service of any matters dealing with its closed branch.

Locally Organized Subsidiary

If a Canadian corporation creates a locally-organized subsidiary in Hong Kong the subsidiary constitutes a separate legal entity from the Canadian parent. Hence the parent corporation would not itself be deemed by Hong Kong authorities to be carrying on business in Hong Kong.

The following are a list of some of the benefits of creating a subsidiary in Hong Kong:

- (1) a subsidiary would be a separate entity in Hong Kong and therefore, the assets of the parent company would be shielded from claims against the subsidiary;
- (2) only the subsidiary would be required to file Hong Kong tax returns. The Canadian parent would not be required to make any filings; and
- (3) it is relatively easy to establish a subsidiary in Hong Kong.

A Hong Kong company may have its liability limited either by shares or by guarantee or it may have unlimited liability. An unlimited liability company would rarely be used. A company limited by shares may be either a public or private company; the form of the company does not result in different tax treatment. The usual form of subsidiary to a Canadian corporation in Hong Kong is that of a private limited

company. As in Canada, the term "limited company" means that the liability of shareholders is limited to the amount, if any, that is unpaid on their shares. A limited company can be formed very quickly and requires little formality; none of the shareholders need to be natural persons and none are required to be Hong Kong residents.

In order to create a private Hong Kong company, two subscribing members, incorporators or shareholders are needed. Memorandum and Articles of Association are filed with the Registrar of Companies who then issues a Certificate of Incorporation indicating the date of incorporation. This certificate is usually issued approximately two months after the date of filing. A locally incorporated company must also obtain a business registration certificate, similar to the type required by a branch. As in Canada, many law firms in Hong Kong have incorporated "shelf companies" which any foreign investor may wish to purchase and thereby lessen the time required to set-up the company.

As with private Ontario companies, the Articles of Association of a Hong Kong company must, a) contain a restriction on the rights of members to transfer their shares; b) limit the number of members to 50; and c) prohibit public solicitation of the shares of the company. Like Ontario companies, a private company may be converted to a public company at any time.

It is usual for a Hong Kong subsidiary to use the name of the Canadian parent with an addition such as (H.K.) or (Far East) before the word "Limited". However, as with branch name registrations, the Registrar has the power to require a subsidiary to change its name if that name is found to be misleading or too similar to the name of a company currently operating in Hong Kong.

As with Ontario companies, there is no minimum authorized capital required to incorporate a private Hong Kong company. However, a nominal amount of authorized capital is required in order to be registered under the Companies Ordinance. Authorized nominal capital may be increased later without difficulty. A typical nominal authorized capital for a wholly-owned Canadian subsidiary is HK\$10,000, divided into 1,000 shares of HK\$10 each. There is no requirement that all of the authorized shares of the company be issued.

The two subscribing members of the private company must take at least one share in the company each and so the Hong Kong subsidiary must at a minimum, issue two (2) shares and have a minimum issued capital reflecting the amount paid for those shares; as a result, the minimum issued capital may be as low as HK\$20. Like Ontario

companies, a Hong Kong company's issued share capital may not be fully paid up. However, unlike Ontario companies, shares can be issued at par value.

Capital duty is payable on the company's authorized capital and on any element of premium over par payable on the allotment of shares at the rate of HK\$6 per HK\$1,000 or part thereof. Stamp duty at the rate of HK\$3 per HK\$1,000 or part thereof is generally payable on any transfer of shares.

A Hong Kong subsidiary must also have at least two directors and a Hong Kong resident company secretary. The company secretary may be an individual or another company. As in Ontario, anyone who is over the age of 18 years may be appointed a director, subject to certain minor exceptions. Unlike Ontario, however, directors of a Hong Kong subsidiary may be corporations. A private company which is affiliated with a public company may not appoint any corporate directors. A Hong Kong subsidiary must also have a registered office in Hong Kong. There is no requirement for meetings of shareholders or directors to be held in Hong Kong. However, a general meeting of shareholders must be held at least once every calendar year. At such a meeting, the general business of the company, such as a review of the accounts, elections of directors and appointment of auditors, may take place.

Other Forms of Business Entities

In addition to forming a subsidiary or a branch in Hong Kong, business may also be carried out in the form of a sole proprietorship or a partnership. Sole proprietorships and partnerships must also be registered under the Business Registration Ordinance. As in the case of Canadian partnerships other than limited partnerships, the partners are jointly and severally liable for all partnership obligations. Like Canadian limited partnerships, limited partners have their liability limited to the amount of their contributions to the partnership and a general partner must be appointed to have unlimited liability for the obligations of the limited partnership.

Foreign Investment and Monopolies

Hong Kong places no restrictions on foreign investments except for investment in the media or public utilities. As a result, Canadian business people may wish to forego the formalities of setting up in Hong Kong and purchase an existing Hong Kong company or its assets. There are a variety of legal and tax considerations to examine in determining whether it is more advantageous to engage in a share or asset purchase. Consequently, the advice of a local lawyer or an accountant should be obtained in this matter.

Hong Kong has no legislation dealing with monopolies, restricted trade practices or joint ventures. However the government of Hong Kong has compiled a set of guidelines for mergers and takeovers entitled the "Hong Kong Code on Takeovers and Mergers". While the Code does not have the force of law in Hong Kong it is complied with by many companies.

The Legalities of the Business Environment

This section, provides a brief overview of some basic regulations that Canadian business people in Hong Kong must be aware of. Needless to say, these regulations raise issues which should be addressed prior to setting up in Hong Kong.

International Trade

Hong Kong began its ascent to economic prominence through world trade, and trade is still an important factor in the Hong Kong economy. Hong Kong is now the world's 8th largest trading entity. Nearly 90% of products manufactured in Hong Kong are exported to countries around the world.

Hong Kong is currently an individual member of the General Agreement on Tariffs and Trade (GATT) and will remain so until 2047. In addition to the GATT, Hong Kong is also bound by restraint agreements with Canada, the United States of America, Austria, Finland, Norway and the European Community which were negotiated pursuant to the Multi-Fibre Arrangement. These agreements regulate the export of certain textiles from Hong Kong to these countries. Quota certificates relating to the export of restrained textiles are issued to exporters by the Hong Kong Trade Department. The current Hong Kong Canada textiles agreement expired on December 31, 1993 and is currently being renegotiated. It is important to review any type of restraint agreement with legal counsel prior to exporting textiles from Hong Kong as these agreements are continually renegotiated.

There are relatively few restrictions on the importation of goods into Hong Kong. Generally such restrictions relate to items which pose a threat to public safety, such as illicit drugs and firearms. In addition there are some duties and tariffs on alcohol, tobacco, some cosmetics and some hydrocarbons.

Franchising

As in many Canadian jurisdictions, Hong Kong has no specific legislation dealing with franchising. The only specific requirement is that the franchisee will be required to register the use of the franchiser's name under the Companies Ordinance. Any franchise arrangement in Hong Kong will be governed by contract law principles. Therefore, it is often left up to Hong Kong courts to interpret the franchise agreement and adjudicate any disputes between the parties. As a British Colony, Hong Kong is a common law jurisdiction like Canada and so many legal concepts in Hong Kong are similar to those found in Canada.

Trademarks, Copyrights and Patents

Trademarks and service marks may be registered in Hong Kong. The registration process is similar to that found in Canada, in that an application with the appropriate mark or design together with information in respect of same must filed with the Intellectual Property Department. Registration of a trademark or service mark will be granted approximately 12 to 16 months after filing provided there are no objections to the application.

The Hong Kong Intellectual Property Department also registers patents. However, the Department is not a registry of original registrations. It registers patents that have previously been granted in the United Kingdom and in some European countries. Such a registration must be made in Hong Kong within 5 years of the date of the grant of the United Kingdom and/or European patent.

In 1972, Hong Kong adopted the United Kingdom Copyright Act, 1956. Hong Kong is also a member of the Universal Copyright Convention and the Berne Copyright Union. Therefore, all companies and persons from countries which are members of these conventions will receive copyright protection in Hong Kong.

Employee Immigration

When a Canadian corporation establishes a presence in Hong Kong it will usually send one or more of its more senior executives or employees to Hong Kong to oversee operations. Generally Canadian employers wishing to relocate Canadian employees to Hong Kong will not encounter many obstacles. In order to work in Hong Kong, Canadians must first obtain a Hong Kong employment visa unless they are either Hong Kong born or carry a United Kingdom passport. An application for a Hong Kong employment visa may be obtained and filed at the British Consulate closest to where the applicant resides and may take up to 12 weeks to process. Hence, it is

important to begin the process as early as possible. In urgent cases, an application may be filed after the applicant has arrived in Hong Kong.

Employment Law

Compared to Canada, Hong Kong has very rudimentary employment legislation. Wages and terminations of employment are covered under the Employment Ordinance. Special provisions relating to paid annual leave, holidays, and rest days, among other things, for workers earning less than HK\$8,500 per month are also contained in this Ordinance. Hong Kong employers are liable to pay their employees full compensation for any employee injuries caused or arising out of their employment. Therefore, much like Canada, employers are required to purchase insurance to cover employee compensation for all workplace injuries.

Taxation

For many Canadian business people, low tax rates are one of the most familiar and attractive aspects of doing business in Hong Kong.

There are three types of direct taxation in Hong Kong;

- (a) a profits tax on business profit;
- (b) a salaries tax on pensions and income from employment; and
- (c) property tax on income from real estate.

Profits Tax

All business entities in Hong Kong are subject to profits tax on profits arising in or derived from a trade or business carried on in Hong Kong. The current rate of profits tax for corporations (including branches of foreign corporations) is 16.5% and the current rate of profits tax for entities other than corporations is a rate of 15%.

There is no tax on dividends paid by a company which is subject to profits tax. Furthermore, there is no tax on accumulated earnings and profits and no requirements that dividends be paid. However, because Hong Kong is not a "listed jurisdiction" for Canadian tax purposes, dividends will be taxable in Canada upon their receipt by the Canadian corporation.

Property Tax

As a general rule all owners of property are liable for property tax at a flat rate of 15% on the "Net Assessable Value" of any property. "Net Assessable Value" is defined as the monies or money's worth paid or payable to the owner for the use of the property after any applicable deductions. A property which is the principal residence of the taxpayer is exempt from property tax. In addition, a taxpayer may avoid property tax if the property is used in a business which is subject to profits tax. Therefore, a corporation which uses its property in the carrying on of business would normally not be subject to property tax but would be liable for profits tax for profits derived from Hong Kong (including revenues from property) at a rate of 16.5%.

Salaries Tax

Subject to certain exemptions, all persons with a Hong Kong source of employment, office or pension income are liable to pay salaries tax. Generally, salaries tax is payable at the lesser of a rate of 15% of net assessable income and the following graduated scale of rates:

- 2% on the first HK\$20,000,
- 9% on the next HK\$30,000,
- 17% on the next HK\$30,000, and
- 20% on the remainder of the salary.

Unlike Canada there is no duty upon the employer to withhold salaries tax at source and remit it to the government.

Tax Treatment of Branches and Subsidiaries by Revenue Canada

At the present time there is no tax treaty between Canada and Hong Kong. Therefore, if a Canadian corporation chooses to set up a branch operation in Hong Kong, the Canadian corporation is responsible for paying the appropriate tax on Hong Kong income as well as the appropriate Canadian tax on its global income (including Hong Kong income). In order to avoid double taxation, Revenue Canada generally allows a Canadian corporation to claim a credit against the tax payable on its global income in an amount equal to the direct tax paid to the Hong Kong government.

Hong Kong subsidiaries of Canadian corporations are only liable for the applicable Hong Kong taxes. Canadian income tax is only exigible in the event that profits from the Hong Kong subsidiary are repatriated to the Canadian parent.

If a Canadian corporation sets up a branch in Hong Kong, the Canadian corporation will be required to make all necessary tax filings in Hong Kong for Hong Kong derived income. On the other hand, if a Canadian corporation sets up a local subsidiary in Hong Kong, only the local subsidiary will be responsible for making all necessary tax filings.

Indirect Taxes

While there is no sales tax in Hong Kong, the Hong Kong government does levy a variety of indirect taxes including betting taxes, stamp duties on securities and property transactions and estate duties. However, these taxes only account for approximately 25% of the total revenue received by the government.

Conclusion

As one can readily see from the issues raised in this booklet, the forms of business entities used in Hong Kong are similar to those business entities used in Canada. In addition, other business issues facing Hong Kong business people, regarding trademarks, patents and employment are similar to those facing Canadian business people. Hong Kong's treatment of business income is the area which is most foreign to Canadian business people. However the low rates of such taxation should more than compensate for any confusion faced in this area.

In conclusion, while the legalities of setting-up business in Hong Kong are not complex, Canadian business people should nonetheless seek professional advice prior to arriving at Kai Tak Airport so that Hong Kong's business environment may be utilized to its full potential.