



PrimeGlobal

*An Association of
Independent Accounting Firms*

DOING BUSINESS IN HONG KONG





COMPANY FORMATION IN HONG KONG

MAIN FORMS OF COMPANY/BUSINESS IN HONG KONG

1. Private Company Limited by Shares

A Private Company Limited by Shares is the most commonly-used company type for the set up of business in Hong Kong. It is a separate legal entity from its parent company, and the liabilities of the shareholders would only be limited to the unpaid portion of the shares that is agreed to be undertaken.

This is a Hong Kong incorporated company for which it can take advantage of all the tax benefits and concessions available, including the Closer Economic Partnership Arrangement (CEPA), a free trade agreement with the mainland China.

2. Branch Office of Parent Company

An overseas parent company could establish a place of business as a branch office for conducting business in Hong Kong. The branch office must register itself as a "Registered Non-Hong Kong Company" within one month of establishment in Hong Kong with the local authority. Unlike a subsidiary limited company, a branch office is not a separate legal entity from the parent company and the parent company is accountable for all the debts and liabilities of the branch office.

3. Representative Office

A Representative Office could be established in Hong Kong for exploring market opportunities and undertaking coordinating activities on behalf of the overseas parent company. A representative office cannot engage in profit making activities (including trading activities, conclusion of any contracts, etc.) and is not treated as a legal entity.

SPECIFIC TAX CONCERNS RELATED TO ESTABLISHING A COMPANY

Generally, Hong Kong has a relatively straight forward tax system and its tax rates are comparatively low. The territorial concept is fundamental to the taxation of profits in Hong Kong, namely only profits arising in or derived from Hong Kong are chargeable to tax in Hong Kong. In short, a person who carries on business in Hong Kong but derives profits from another place is not required to pay tax in Hong Kong on those profits. Hence it is important to structure your business upon establishment in order to reduce possible tax burden.

Every company has the obligation to complete and file the tax return within a prescribed time once it is issued. In general, newly registered business will receive its first profits tax return some 18 months after the date of incorporation.

LEGAL ISSUES RELATED TO ESTABLISHING A COMPANY

Requirement	Company Limited by Shares	Branch Office	Representative Office
Director	<ul style="list-style-type: none"> Both corporation and natural person could be director Minimum requirement: must consist of one natural director 	<ul style="list-style-type: none"> Only require to report the details of directors of parent company 	<ul style="list-style-type: none"> N/A



Requirement	Company Limited by Shares	Branch Office	Representative Office
Shareholder	<ul style="list-style-type: none"> • Both corporation and natural person could be shareholder • Number of shareholders must be less than 50 • Minimum requirement: one shareholder 	<ul style="list-style-type: none"> • N/A 	<ul style="list-style-type: none"> • N/A
Company secretary	<ul style="list-style-type: none"> • Must appoint at least one individual resident in Hong Kong or another Hong Kong limited company 	<ul style="list-style-type: none"> • Not required 	<ul style="list-style-type: none"> • N/A
Registered office	<ul style="list-style-type: none"> • Must have an office address in Hong Kong as the registered office 	<ul style="list-style-type: none"> • Must have an office address in Hong Kong 	<ul style="list-style-type: none"> • N/A
Authorised representative	<ul style="list-style-type: none"> • N/A 	<ul style="list-style-type: none"> • Must appoint at least one natural person resident in Hong Kong, or solicitor or CPA authorised by the law 	<ul style="list-style-type: none"> • N/A
Auditor	<ul style="list-style-type: none"> • Must appoint an auditor 	<ul style="list-style-type: none"> • N/A 	<ul style="list-style-type: none"> • N/A
Business registration	<ul style="list-style-type: none"> • Yes 	<ul style="list-style-type: none"> • Yes 	<ul style="list-style-type: none"> • Yes

CULTURAL CONCERNS RELATED TO ESTABLISHING A COMPANY

Official Languages and Company Names

Hong Kong is a Special Administrative Region of the People’s Republic of China and it offers easy access to business opportunities in mainland China both geographically and commercially. Chinese and English are the official languages of Hong Kong. While Cantonese is the commonly spoken language in the community, English is widely used in the Government and by the legal, professional and business sectors. A company could use both Chinese and English names in order to conduct business effectively in Hong Kong as well as with mainland China.

Chinese Calendar and Fengshui

It is common in Hong Kong for newly established business to consult the Chinese calendar to determine the best date and time for business opening. Fengshui is another important Chinese culture for establishing business. Fengshui is the Chinese-oriented belief that the surrounding environment would benefit a person’s own being. Not only local business entrepreneur in Hong Kong but also international enterprises having offices in Hong Kong consult fengshui when sourcing for office locations.

OTHER COUNTRY-SPECIFIC ISSUES RELATED TO ESTABLISHING A COMPANY

Hong Kong operates under the principle of ‘one country, two systems’, which gives the city a high level of autonomy and different from other parts of the world. Such bi-cultural environment gives Hong Kong a unique position in the world for running a business.

Hong Kong’s history as a British colony and its present unique principle of ‘one country, two systems’ with the mainland China enable Hong Kong to be a bi-cultural city nowadays. Such British influence within a Chinese culture is an enormous advantage for foreign enterprises setting up their business in Hong Kong and to access the market of the mainland China easily.



PERMANENT ESTABLISHMENT IN HONG KONG: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

The definition of a Permanent Establishment (“PE”) in Hong Kong mirrors the same by the Organization for Economic Co-operation and Development (“OECD”). A PE is generally considered as a fixed place of business through which the business activities of the company are wholly or partly carried on, it could be a branch, a representative office, or other place of business. Therefore, in determining whether the activities of a company constitute a PE, three criteria are to be considered, namely space, time and function. Space refers to a fixed place of business, which may include a house, a site, equipment or facilities, a warehouse, a place for extraction of natural resources, etc., whether owned or rented by the company. Secondly, the term “Permanent Establishment” implies a degree of permanence while disallowing the effect of any temporary suspension of business activities. Moreover, if the fixed place of business only carries out preparatory or auxiliary activities such as solely for the purpose of storage or purchase of goods or collection of information and etc., it would not constitute a PE, considering that the preparatory or auxiliary activities do not by themselves generate profits.

An overseas company would not be deemed to have a PE in Hong Kong if it only carries on business through an independent agent who is merely acting in the ordinary course of its business, unless the agent regularly acts on behalf of that company and has authority to negotiate or conclude contracts in its name.

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

The main difference between a subsidiary and a branch is that a subsidiary is an independent legal entity separate from its owners, as such the parent company would not be liable for the debts of its subsidiary and its legal liability towards the subsidiary would be limited to the amount of any unpaid registered share capital; whilst a branch is not a separate legal entity and the company is accountable for all the debts and liabilities of the branch. On the other hand, a branch can rely on the credit from the company and it would adopt the company’s name and carry out the same business activities.

TAX AND ACCOUNTING OBLIGATIONS

In terms of tax and accounting obligations, there is little difference between operating a branch and a subsidiary in Hong Kong. Every person carrying on business in Hong Kong is required to keep sufficient records and books of account of its income and expenditure to enable the assessable profits to be readily ascertained and shall maintain such records for at least 7 years after the completion of the transactions. Failure to do so is an offence which may render the person liable to be fined. A company is required to prepare audited financial statements each year, but it is not mandatory for a branch or a dormant company to do so.

The primary taxes levied in Hong Kong are profits tax, salaries tax and property tax. There is no capital gains tax or valued-added tax in Hong Kong. Profits tax is levied only on “revenue profits” and not income of a capital nature; its tax rate is 16.5% for corporations and 15% for individuals and unincorporated business, including branches. Loss incurred in the production of assessable profits may be carried forward indefinitely and could be offset against the assessable profits in the subsequent years. Unless specifically exempted, a person carrying on business in Hong Kong is required to file an annual Profits Tax Return to the Inland Revenue Department for final tax and provisional tax purposes together with the audited financial statements and a profits tax computation in support.



REGISTRATION FORMALITIES

Under the one-stop company and business registration service, any person who applies for incorporation of a local limited company, such as a subsidiary company, or register of a non-Hong Kong company will be deemed to have made a simultaneous application for business registration. Upon approval of an application for company incorporation, the Companies Registry will issue the Certificate of Incorporation and the Business Registration Certificate in one go. The business registration certificate should be renewed annually by settling the payment on the renew demand note issued by the Business Registration Office. The valid business registration certificate must be displayed in a conspicuous place at the address where the business is carried on.

Apart from business registration, a Hong Kong company is also required to deliver an annual return to the Companies Registry within 42 days after the anniversary of the date of the company's incorporation every year. The annual return contains the particulars of the company such as its shareholders, directors, secretary, the registered office address, etc. The annual return should be submitted even if the information contained in the last return has not changed.

A company should also ensure that the information recorded at the Companies Registry is up-to-date by notifying them any changes relating to the company particulars as mentioned above within the prescribed time period.

STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

Like a subsidiary company, a branch office must also be registered with the Companies Registry. However, the one-stop company and business registration service is not applicable to the registration of a branch office; therefore, the application for branch registration shall be lodged directly with the Business Registration Office of the Inland Revenue Department in advance. Similarly, a branch office must also comply with the compliance requirements like renewal of the branch registration, filing annual returns, notify changes of company particulars, filing profits tax returns and etc.

Comparing with a subsidiary company, a branch office's ongoing maintenance cost is lower. For instance, a separate audit of a branch office is not mandatory in Hong Kong. Upon cessation of the Hong Kong branch, the capital can be easily remitted back to the parent company. On the other hand, the documents and information of the parent company are required for the registration of a Hong Kong branch. A Hong Kong branch office must appoint at least one Hong Kong resident agent (either an individual or an authorised corporation) to accept legal notice served to the branch.



HOW TO HIRE MY FIRST EMPLOYEE IN HONG KONG

MAIN LEGAL STEPS TO FOLLOW TO HIRE A FIRST EMPLOYEE

Before bringing on board a first employee hire, the employer should pay attention to the following main legal issues:

Job advertisement

It is vital that when advertising for a position, the employer does not include any requirements or statements in the advertisement which could be considered discriminatory (such as sex, race, age, marital status or asking for a photo to be provided as part of the application form).

Interview process

Similarly, it is important that when interviewing candidates, an objective selection criteria is used to avoid any potential discriminatory claims being raised by candidates. In this regard, employers should stick to asking candidates questions relating to their work experiences and qualifications rather than personal questions which are irrelevant in determining whether a candidate is suitable for the advertised position.

Background checks

It is prudent for an employer to obtain at least one or two reference checks from a candidate that it wishes to hire before making a formal offer. The employer should obtain a candidate's consent before conducting any background checks.

Offer of employment

Typically, an employer will make a verbal offer to a candidate. If that candidate accepts the verbal offer, a formal employment contract will then be prepared and executed by the parties. We will discuss what is usually included in an employment contract in the next question.

Immigration

All employees in Hong Kong must hold appropriate work visas before commencing work unless they have a right of abode. If a work visa is required, the employer will need to sponsor the new employee.

DESIGN AND CONTENTS OF AN EMPLOYMENT CONTRACT

In preparing an employment contract, the employer should be aware of the minimum statutory requirements prescribed under the Employment Ordinance and other related legislation. We will set out some of the main terms that are typically included for an average employee who will be employed "continuously" (that is, an employee who will be employed on a continuous basis for at least four weeks and will work 18 hours or more each week):

Term - can be fixed or ongoing. Importantly, any contract for a duration in excess of one month must be in writing; otherwise, it will be deemed to be a contract for one month renewable from month to month.

Wages - an employee must be paid at least minimum wage (currently set at HK\$32.5 per hour). Wages are usually paid monthly in Hong Kong.

Bonuses - bonus payments are not mandatory in Hong Kong. However, employers in Hong Kong typically provide employees with an end-of-year bonus ("13-month payment" or "double pay").



Annual Leave - employees are entitled to a minimum of 7 to 14 days' annual leave for each 12 month period of employment depending on their length of service.

Other Leave - the Employment Ordinance also sets out other types of leave which must be adhered to, including statutory holidays, sick leave, maternity leave and the recently introduced paternity leave.

Mandatory Provident Fund - the MPF scheme was introduced in Hong Kong to assist employees with their retirement savings. Both the employer and employee are required to contribute a rate of 5% of the employee's relevant income up to a statutory limit (currently set at HK\$1,500 per month).

Termination - both the employer and employee may terminate the employment relationship by providing notice or payment in lieu of notice. The notice period must not be less than 7 days, except in limited circumstances. For instance, no notice or payment in lieu is required if an employer decides to summarily dismiss an employee due to serious misconduct.

Other clauses may include protection of confidential information, non-competition, and governing law.

CAN SOMEBODY DO BUSINESS FOR ME AND NOT BE AN EMPLOYEE?

In Hong Kong, there are different methods in which a company can engage an individual other than in the capacity as an employee.

The most common is as an independent contractor. Independent contractors are used frequently in the construction industry, among others. Whether someone is an independent contractor can sometimes be a difficult question. Some factors which indicate that someone is an independent contractor and not an employee include the fact that they have control over their work schedule (that is, they are not subject to the employer's day-to-day control), they can use their own equipment, and they have the power to hire their own people to complete the job at hand.

Another common method is the use of agency workers. In general, the agency will provide an individual to work for you. In this type of arrangement, it is generally the agency and not you which is considered the worker's employer.



HOW TO READ FINANCIAL STATEMENTS IN HONG KONG

XYZ Group

Statement of financial position as at 31 December 20X4

(Amounts expressed in /// dollars)

	<u>20X4</u>	<u>20X3</u>
ASSETS		
Non-current assets		
Property, plant and equipment	xxx	xxx
Goodwill	xxx	xxx
Other intangible assets	xxx	xxx
Investments in associates	xxx	xxx
Available-for-sale financial assets	xxx	xxx
	<hr/> xxx	<hr/> xxx
Current assets		
Inventories	xxx	xxx
Trade receivables	xxx	xxx
Other current assets	xxx	xxx
Cash and cash equivalents	xxx	xxx
	<hr/> xxx	<hr/> xxx
Total assets	<hr/> <hr/> xxx	<hr/> <hr/> xxx



EQUITY AND LIABILITIES

Equity attributable to owners of the parent

Share capital	XXX	XXX
Retained earnings	XXX	XXX
Other components of equity	XXX	XXX
	<hr/>	<hr/>
	XXX	XXX

Non-controlling interests

Total equity	<hr/>	<hr/>
	XXX	XXX
	<hr/>	<hr/>

Non-current liabilities

Long-term borrowings	XXX	XXX
Deferred tax	XXX	XXX
Long-term provisions	XXX	XXX
	<hr/>	<hr/>
Total non-current liabilities	XXX	XXX
	<hr/>	<hr/>

Current liabilities

Trade and other payables	XXX	XXX
Short-term borrowings	XXX	XXX
Current portion of long-term borrowings	XXX	XXX
Current tax payable	XXX	XXX
Short-term provisions	XXX	XXX
	<hr/>	<hr/>
Total current liabilities	XXX	XXX
	<hr/>	<hr/>

Total liabilities	<hr/>	<hr/>
	XXX	XXX
	<hr/>	<hr/>

Total equity and liabilities	<hr/>	<hr/>
	XXX	XXX
	<hr/>	<hr/>



XYZ Group

Statement of profit or loss and other comprehensive income for the year ended 31 December 20X4

(Amounts expressed in /// dollars)

	<u>20X4</u>	<u>20X3</u>
Revenue	xxx	xxx
Cost of sales	xxx	xxx
Gross profit	<hr/> xxx	<hr/> xxx
Other income	xxx	xxx
Distribution costs	xxx	xxx
Administrative expenses	xxx	xxx
Other expenses	xxx	xxx
Finance costs	xxx	xxx
Share of profit of associates	xxx	xxx
Profit before tax	<hr/> xxx	<hr/> xxx
Income tax expense	xxx	xxx
PROFIT FOR THE YEAR	<hr/> xxx	<hr/> xxx
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Gains on property revaluation	xxx	xxx
Remeasurements of defined benefit pension plans	xxx	xxx
	<hr/> xxx	<hr/> xxx
	<hr/>	<hr/>



Items that may be reclassified subsequently to profit or loss:

Exchange differences on translating foreign operations	xxx	xxx
Available-for-sale financial assets	xxx	xxx
	xxx	xxx

Other comprehensive income for the year, net of tax

TOTAL COMPREHENSIVE INCOME FOR THE YEAR	xxx	xxx
	xxx	xxx

Profit attributable to:

Owners of the parent	xxx	xxx
Non-controlling interests	xxx	xxx
	xxx	xxx
	xxx	xxx

Total comprehensive income attributable to:

Owners of the parent	xxx	xxx
Non-controlling interests	xxx	xxx
	xxx	xxx
	xxx	xxx

Earnings per share*

Basic and diluted	xxx	xxx
	xxx	xxx

* Applicable to listed companies



XYZ Group

Statement of cash flows for the year ended 31 December 20X4

(Amounts expressed in /// dollars)

	<u>20X4</u>	<u>20X3</u>
Cash flows from operating activities		
Profit before taxation	xxx	xxx
Adjustments for:		
Depreciation	xxx	xxx
Foreign exchange loss	xxx	xxx
Investment income	xxx	xxx
Interest expense	xxx	xxx
	<hr/>	<hr/>
Increase in trade and other receivables	xxx	xxx
Decrease in inventories	xxx	xxx
Decrease in trade payables	xxx	xxx
Cash generated from operations	<hr/>	<hr/>
Interest paid	xxx	xxx
Income taxes paid	xxx	xxx
<i>Net cash from operating activities</i>	<hr/>	<hr/>
	<hr/>	<hr/>



Cash flows from investing activities

Acquisition of subsidiary net of cash acquired	xxx	xxx
Purchase of property, plant and equipment	xxx	xxx
Proceeds from sale of equipment	xxx	xxx
Interest received	xxx	xxx
Dividends received	xxx	xxx
<i>Net cash used in investing activities</i>	xxx	xxx

Cash flows from financing activities

Proceeds from issue of share capital	xxx	xxx
Proceeds from long-term borrowings	xxx	xxx
Payment of finance lease liabilities	xxx	xxx
Dividends paid	xxx	xxx
<i>Net cash used in financing activities</i>	xxx	xxx

Net increase in cash and cash equivalents

Cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

xxx xxx

xxx xxx

xxx xxx