Deloitte Touche Tohmatsu

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Hong Kong

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Snapshot

Population	6.8m
Population growth	0.9%
Land area	1,099 sq km
Fiscal year	Starts April 1st
Currency	Hong Kong dollar (HK$); HK$7.79:US$1 (2001, average)
GDP	HK$1.3trn (2001); US$161.9bn (2001, market exchange rate)
Origin of GDP (% of GDP—2001)	
Agriculture	0.1%
Industry	13.9%
Services	86.0%
GDP growth	0.1% (2001)
GDP per head	US$24,048 (2001, at market exchange rates)
Inflation	-1.6% (2001)

Background

Under the terms of the Sino-British Joint Declaration on the Question of Hong Kong, signed in 1984 by China and the UK, Hong Kong reverted to Chinese sovereignty on July 1st 1997 as a Special Administrative Region (SAR) of the People's Republic of China, and was promised a "high degree of autonomy" for at least 50 years from that date. The SAR is ruled according to the Basic Law of the Hong Kong SAR, which functions as a mini-constitution for the territory.

Political Structure

The SAR is administered by the chief executive, Tung Chee-hwa, a former shipping magnate appointed by a 400-strong committee chosen by the Chinese government. Mr Tung's first term of office lasts until 2002. The chief executive is advised by an appointed Executive Council (Exco) and oversees policy secretaries whose roles resemble those of ministers in national governments. The second Legislative Council (Legco) under Chinese rule was elected by restricted franchise in September 2000.

Policy Issues

The main challenge facing the Hong Kong government is to maintain the SAR's competitiveness as an international trade and financial services hub in the face of strong competition from Singapore, Shanghai and other regional centres. At the same time, it has to manage the end-game in the transition from the manufacturing economy that began to disappear in the early 1980s to the emerging knowledge economy. The government is increasingly turning its attention to issues such as education and the environment in the growing recognition that talent is valuable--and footloose.

Foreign Trade

The trade deficit more than doubled in 2000, reaching US$8.2bn (balance-of-payments basis), compared with US$3.2bn in 1999. Total merchandise export value rose by 16% to US$202.7bn, while imports grew by 18.6% to US$210.9bn. As a result, the current-account surplus slipped from US$11.5bn in 1999 to US$8.8bn in 2000, despite a much larger surplus on services trade.

Major exports	**% of total**
Clothing & accessories	47.0
Electrical machinery	25.7
Textiles	5.3
Jewellery	3.0
Major imports	**% of total**
Consumer goods	34.6
Raw materials & semi-manufactures	32.6
Capital goods	27.3
Foodstuffs	3.6
Leading markets	**% of total**
China	36.9
US	22.3
UK	5.8
Germany	4.1

Taxation

The tax rate on corporate profits is 16%, and that on unincorporated businesses is 15%. The standard rate of salaries tax is 15%. The Mandatory Provident Fund (MPF) requires a minimum contribution of 5% from both employer and employee.

Dividends and interest are paid without withholding tax. The rate on royalties is 1.6%.

1.0 The Investment Climate

1.1 General

Land area	1,098 sq km
Hong Kong Island	80 sq km
Kowloon	47 sq km
New Territories and outlying islands	971 sq km
(Reclamation since 1851)	61 sq km
Population	6,708,389 March 2001 census, 6.52m usual residents; 180,000 mobile residents
Main regions	Population in '000
Hong Kong Island	1,335
Kowloon	2,024
New Territories	3,343
Marine	6
Climate	Sub-tropical
Weather in Victoria	Hottest months, July and August, 26-31• C; coldest month, January 15-19•C; driest month, January, 23 mm average rainfall; wettest month, august 391 mm average rainfall (climatological normals)
Languages	English and Chinese (mainly Cantonese)
Measures	UK imperial system changing to metric system

1.2 Political background

On July 1st 1997 Hong Kong, which had been a UK colony since 1841, became a Special Administrative Region (SAR) of the People's Republic of China (PRC). Hong Kong is now ruled on the basis of a mini-constitution, the Basic Law, which guarantees the SAR its own legislature, legal and judicial system, and full economic autonomy, while giving the central government in Beijing responsibility for defence and foreign affairs. The SAR has an executive-led government, headed by the chief executive, Tung Chee-hwa, who was re-elected by an 800-member Election Committee in February 2002. To coincide with the beginning of his second term in office on July 1st, Mr Tung introduced government reforms, replacing the civil servants who had previously headed departments with limited-tenure political appointees (many of whom were, however, recruited from the ranks of the civil service). The current Legislative Council (Legco) was formed by restricted-franchise elections in September 2000; the next Legco election is due to be held in 2004.

1.3 Economic structure

Hong Kong is first and foremost a trading centre. It has virtually no natural resource base and is therefore dependent on imports for raw materials, food and fuel. Domestic demand, though increasingly important, is limited by the size of the population. In 2001 total exports and imports of goods and services (national accounts terms) amounted to HK$1.82trn and HK$1.75trn, or a combined 283% of current-price GDP.

Hong Kong is different from the other Asian newly industrialising countries (NICs). Although all four started out as low-cost, labour-intensive manufacturing bases, Singapore, Taiwan and Korea have all developed high-technology industries, whereas Hong Kong has become a services centre, in particular for companies (foreign as well as those from Hong Kong) doing business in China. The structure of the economy has therefore changed dramatically over the past decade: the manufacturing sector, which in 1980 accounted for 22.4% of GDP, contributed just 5.6% of GDP in 2000 (latest available figure) and in 2001 employed only 2.2% of the labour force. The manufacturing sector has been replaced by a rapidly expanded services sector. By 2000 tertiary industry generated just under 64% of GDP, but was producing nearly 82% of Hong Kong's annual economic output. Hong Kong's two largest service sectors in 2000 were import and export trade, and community, social and personal services.

With the government disliking regulation, Hong Kong has traditionally lacked the legislative and institutional measures that are used elsewhere to encourage competition. Partly because of this, there has been criticism that the domestic economy is monopolised by a few powerful local conglomerates. For instance, just two chains--Wellcome and ParknShop--enjoy a combined market share in the supermarket industry that is estimated to be as high as 60-70%. These two firms are in turn owned by conglomerates, Jardine Matheson and Hutchison Whampoa, respectively, which have a range of other interests in Hong Kong, owning, for example, major land developers. The government has taken steps to increase competition in recent years, though its efforts have so far been limited largely to those areas over which it exerts a direct influence. However, although the economy is not as competitive as the government tends to claim, it is not as monopolised as critics allege either—according to an IMF working report issued in August 2000, Hong Kong's economy is "neither significantly more nor significantly less competitive than the average OECD economy".

Comparative economic indicators, 2002

	Hong Kong	**Singapore**	**Taiwan**	**US**	**Jap**
GDP (US$ bn)	168.9	88.6	278.6	10,449	3,9
GDP per head (US$)	24,820	20,920	12,357	36,416	31,
Consumer price inflation (av; %)	-2.9	-0.1	0.2	1.6	-1.
Current-account balance (US $ bn)	13.4	19.1	16.7	-489.5	110
Exports of goods fob (US $ bn)	197.2	130.9	131.9	686.0	397
Imports of goods fob (US $ bn)	-202.8	-116.4	-112.1	-1,157.6	-31

1.4 Currency

Hong Kong's currency is the Hong Kong dollar. The Hong Kong dollar is pegged to the US dollar at a central rate of HK$7.8:US$1, and it trades only within a very narrow band around this rate. As a result, the exchange rate of the Hong Kong dollar against other major currencies follows the US dollar.

Although the official exchange rate is fixed, a market-determined exchange rate is available for transactions among banks and between banks and the public. The possibility of arbitration helps to keep the official rate and the market rate aligned.

1.5 Attitude towards foreign investment

The government, local business, media and the public have favourable attitudes towards foreign investment. Attracting foreign investment is a priority, and a government network of economic and trade offices in ten cities worldwide promotes overseas investment in Hong Kong. Foreign investment is widely considered beneficial, even crucial, for economic stability, and there is tacit rivalry with Singapore over the amount of investment made in each country--and even the number of multinational headquarters in each region.

The major advantages of doing business in Hong Kong are the country's geographic location, communications network, infrastructure, free-port status and the relatively low level of taxes. A well-established and transparent legal system inherited from the British gives Hong Kong an edge over mainland Chinese cities such as Shanghai. There are also no restrictions on foreign ownership of property or companies and no foreign-exchange controls in the Special Administrative Region (SAR). Hong Kong is a premier capital-raising centre, especially for mainland Chinese companies. Disincentives include expensive labour, high rents and the poor quality of the environment.

Although property prices have fallen about 60% from their peaks in 1997, Hong Kong remains one of the most expensive places in the world to lease office space. Grade-A office space in Hong Kong is more than twice as expensive as it is in Shenzhen and Guangzhou, mainland locations just across the border, according to property consultant DTZ Debenham Tie Lung. Standard and Poor's has predicted that grade-A office rentals could decline by 10-20% by September 2003.

In April 2002 the Economist Intelligence Unit ranked Hong Kong second only to Singapore as the best place to do business in Asia for the period 2002-06. Hong Kong had held the number-one spot for 1997-2001, but four factors cited affected Hong Kong's score for the present period: an erosion of political autonomy from the mainland; continually worsening economic conditions; concerns about cartels; and the lack of skills among workers.

There are concerns that, following China's entry into the World Trade Organisation in December 2001 and the subsequent flow of foreign direct investment (FDI) to the mainland, the amount of FDI going into Hong Kong might fall. Some foreign investors have indeed downsized their presence in the SAR and moved their money to China, gradually diminishing Hong Kong's role as the sole gateway to the mainland. But figures for FDI flows in 2002 are not yet available to support this speculation.

According to the United Nations Conference on Trade and Development (UNCTAD), FDI in Hong Kong plunged 60%, to US$22.8bn in 2001, from US$61.9bn in 2000. The sharp fall resulted mainly from a very high base of comparison, since the 2000 figure had included a single large acquisition in telecommunications valued at US$24bn. Despite the dramatic fall of inflows to Hong Kong in 2001, the territory was still the third-largest recipient of FDI in the developing world during the year, following mainland China and Mexico.

UNCTAD said that Hong Kong's role as a business hub for the region continued to solidify in 2001, as the number of transnational companies with regional offices in the SAR climbed 8%, to 3,237 from its 2000 level, including 944 regional headquarters.

By June 2002, 948 regional headquarters had been established in Hong Kong, slightly up from the 944 in the same month in 2001, according to the SAR's Census and Statistics Department. The number of regional offices of multinationals fell to 2,171, however, in the first half of 2002 from 2,293 in the same period of 2001. The number of foreign companies in Hong Kong climbed to 6,637 in the first nine months of 2002, from 6,344 in the same period in 2001.

UNCTAD predicted a decline in FDI inflows to Hong Kong in 2002, partly because of the repayment of outstanding intra-company debts held by foreign affiliates. (This means that foreign affiliates operating in Hong Kong pay more loans back to their parent firms than they receive from them.)

According to the most recent data available from the Census and Statistics Department and the Industry Department, the stock of inward direct investment amounted to US$455.3bn at end-2000, up from US$403.8bn at end-1999. Analysed by the immediate source of investment, the British Virgin Islands accounted for 31.9% of the total stock of inward direct investment at end-2000, followed by mainland China, which accounted for 31.3%. Bermuda and the Cayman Islands took up another 9.6% and 2.5%, respectively, reflecting in part the common practice of Hong Kong enterprises setting up non-operating companies in offshore financial centres (tax havens) for channelling direct investment funds back to Hong Kong, and in part the means by which foreign enterprises channel their funds to Hong Kong. Other major sources of inward direct investment included the Netherlands and the United States, accounting for 6.3% and 4.5%, respectively, of the total.

Besides the Industry Department, which is assuming an expanded role, Hong Kong's General Chamber of Commerce and the semi-official Hong Kong Trade Development Council promote investment from abroad. The head office of Invest

Hong Kong or the Invest Hong Kong desk at the Economic and Trade Offices in various cities abroad also offer help in setting up a business in Hong Kong.

Holding patterns

Many foreign companies have downsized their operations in Hong Kong and moved investment to mainland China following the latter's accession to the World Trade Organisation in December 2001. For example, Advanced Micro Devices, a chipmaker based in the US, moved its South Asia-Pacific headquarters from Hong Kong to Shanghai in October 2002. The company said the move reflected Shanghai's importance as a manufacturing centre.

Hong Kong's stagnant economy undercut sales and presented a further obstacle to foreign investment. In April 2002 Oracle, a US software giant, deferred its plan to establish a research lab at Hong Kong's brand-new Cyberport, which the SAR hopes to turn into its own version of the US's Silicon Valley. Oracle is now expressing greater interest in its prospects on mainland China, particularly in Shenzhen, where it opened a research-and-development centre in June 2002.

A number of Japanese companies closed operations in Hong Kong because of Japan's own recession. The Census and Statistics Department said that 471 Japanese companies had regional offices in the SAR in June 2002, down from 533 in June 2001. Fuji Television Network, for example, closed its Hong Kong office in September 2002 to cut costs.

1.6 Banking and financing

Hong Kong's banking sector is the world's tenth largest in terms of external transactions, and it hosts 78 of the world's top 100 banks. Hong Kong returned without disruption to Chinese sovereignty as a Special Administrative Region (SAR) in July 1997. Though it faces competition for Asian banking and other financial business from such cities as Singapore and Sydney, its reintegration with the mainland has made it the main centre for external trade and finance with China.

Hong Kong maintains a three-tier system of deposit-taking institutions--namely, licensed banks, restricted licensed banks (RLBs) and deposit-taking companies (DTCs)--all collectively known as authorised institutions (AIs). At end-November 2000 there were 149 licensed banks, 48 RLBs and 55 DTCs in business. These 252 AIs operate a comprehensive network of some 1,527 local branches.

Only licensed banks may operate current and savings accounts and accept deposits of any size and maturity. RLBs are only allowed to accept deposits of HK$500,000 and above; DTCs are only permitted to accept deposits of a minimum of HK$100,000, with original maturity of not less than three months. RLBs and DTCs both provide an opportunity for overseas banks not qualified for a full banking licence to set up establishments in Hong Kong to conduct wholesale- and investment-banking businesses. Licensed banks must have paid-up share capital of at least HK$150m and total assets of at least HK$4bn. RLBs must have paid-up share capital of at least HK$100m; DTCs need at least HK$25m. A banking group may set up all three entities, but the major banks usually have two establishments: a bank branch and an investment bank, which can be either an RLB or a DTC.

Licensed banks, commonly known as commercial banks, provide retail-banking services. They accept deposits of any size and maturity; grant loans and advances; discount trade bills and banker's acceptances; deal in gold, foreign exchange and securities; and provide business consultative services and private banking.

RLBs, commonly known as investment or merchant banks, principally engage in merchant-banking and capital-market activities. Many of them are subsidiaries of large commercial banks. They take deposits of large denominations, underwrite securities, deal in foreign exchange and securities, and provide financial-advisory services in issuance of securities and for mergers and acquisitions.

DTCs, or finance companies, are mostly owned by or otherwise associated with banks. These companies take deposits from the public and engage in a range of specialised activities, including consumer finance, trade finance, leasing, factoring and securities business.

The government has carried out gradual deregulation of banking since 1999. In December 2001 the Hong Kong Monetary Authority (HKMA--the central bank) lifted all branching restrictions on foreign banks and removed all interest rate regulations. It also suggested further liberalisation of the industry, with a proposal to reduce the minimum asset requirement for foreign banks.

The globalisation of capital markets has intensified competition in banks' traditional business of lending. In Hong Kong the higher degree of competition has caused a sharp drop in lending margins, particularly on residential mortgages. This competitive environment has threatened the profitability of smaller banks, driving the consolidation of the banking system in 2001.

Another key recent development for the banking sector was the full implementation of the Mandatory Provident Fund Scheme (MPF), Hong Kong's first compulsory retirement scheme. The scheme has provided banks with both a chance to earn a stream of annuity-type revenue stretching into the distant future and with opportunities for cross-selling other banking products, such as funds, to a larger market.

The strength of Hong Kong's banking sector arises from its 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 has a forward position to finance China's continuing economic development. Since the early 1980s Hong Kong banks have been providing commercial banking facilities to finance mainland trade and investment projects. Bankers have built a wealth of knowledge on credit-risk assessment. In response to relaxation of China's banking rules, Hong Kong banks were among the first to expand their operations there. The SAR is also a leading centre in Asia for raising venture capital and arranging syndicated loans.

According to the HKMA, total assets of authorised institutions operating in Hong Kong stood at HK$2.9trn at end-September 2001.

1.7 Foreign trade

The Basic Law stipulated that Hong Kong would independently participate in international trade agreements and issue independent certificates of origin after the handover. The transition agreements ensure that Hong Kong retains its border controls with China, its own customs procedures and the right to conduct international trade relations. Hong Kong is a member of the World Trade Organisation and the Asia-Pacific Economic Co-operation (APEC) forum, which is moving to liberalise the region's import restrictions by 2010-20.

Some 90% of Hong Kong's exports were re-exports. Using competitive manufacturing bases in China, Hong Kong has become the world's leading re-exporter of garments, imitation jewellery, travel goods, handbags, umbrellas, artificial flowers, toys and clocks. In recent years, however, there has been increasing use of direct shipments or transshipments of goods manufactured in mainland China to overseas markets at the expense of re-exports through Hong Kong. This trend should increase in future, now that China is a member of the WTO.

Apart from re-exports, Hong Kong's domestic exports consist mostly of the following: (1) textiles; (2) clothing apparel; (3) machinery, equipment, apparatus, parts and components; and (4) consumer electrical and electronic products. These four major industries accounted for 76% of Hong Kong's total domestic exports of manufactured goods in the second quarter of 2002, according to the Census and Statistics Department. Its main imports include raw materials, consumer goods, capital goods, foodstuffs and fuels.

Hong Kong's major export markets are mainland China, the United States, Japan and Germany. Its main sources of imports are mainland China, Japan, Taiwan and the US.

Following a slowdown in the global demand for its products in 2001, Hong Kong saw its total exports of goods rise by 2% in the first nine months of 2002 on the same period in the previous year. Re-exports increased by 4% in the nine months to September 2002, a turnaround from a 2.1% decline in the same period in 2001. But domestic exports continued to decline--by 15.5%, which was slightly more than the 15% fall in the same period in 2001.

The value of total imports of goods declined slightly in the first nine months of 2002, by 0.5%. Taken together, a visible trade deficit of HK$48.2bn was posted for the period, down sharply from a HK$76bn gap recorded in the first nine months of 2001.

The annual renewal of China's most-favoured-nation (MFN) trade status by the US is a critical factor in Hong Kong's external trade, because much of China's exports to the US are re-exports from Hong Kong-owned factories in China. Hong Kong's secretary for trade and industry has said that revoking MFN would be catastrophic for Hong Kong's economy.

Hong Kong also had a clear interest in China's WTO entry, which occurred in December 2001. As well as obliging China to respect multilateral rules and disciplines, membership curtails other countries' freedom to take unilateral trade sanctions against it and ensure that trade disputes are settled through binding international arbitration. Since more than half of China's exports pass through Hong Kong, liberalised trading rules for China will significantly benefit Hong Kong.

In general, any person who imports or exports any goods must lodge an import/export declaration with the Customs and Excise Department within 14 days after the importation or exportation of goods. The declaration can be made on a prescribed form or via Electronic Data Interchange Service. At the time of lodging declarations, importers and exporters must pay a declaration charge and/or export clothing training levy.

2.0 Labour Relations and Work Force

2.1 General

The size of Hong Kong's labour force at end-December 2002 was estimated by the Census and Statistics Department to be 3.5m, of which 3.26m persons were employed. The unemployment rate has been growing since early 2001, when economic growth began to falter. Although the unemployment rate fell to 7.2% in the fourth quarter of 2002--from a record high of 7.8% in the second quarter--pessimism over the short-term outlook persists given the loss of most manufacturing jobs to China and the downturn in the high-technology sector.

The workforce is relatively well educated. Hong Kong's primary and secondary schools provide mandatory programmes for the population up to age 15. The schools are generally well run and supply a trainable corps of labourers to the market. Students are taught in native Cantonese in primary school and switched to English at the secondary level. Most higher education takes place at seven government-financed institutions: Chinese University of Hong Kong; City University of Hong Kong; Hong Kong Baptist University; Hong Kong Polytechnic University; Hong Kong University of Science and Technology; Lingnan University; and University of Hong Kong.

Despite a relatively well-educated population, concern has been growing about the shortage of a well-trained workforce to compete in a high-tech, service-oriented economy. Some employers complain that graduates are poor in both English and Mandarin, Hong Kong's two official languages.

To address a shortage of information-technology skills, the government launched a five-year strategy called Information Technology for Learning in a New Era in 1998. Internet connectivity is now available in all secondary and tertiary schools, and about 25% of the curriculum is taught using information technology.

The government projects a shortage of as many as 120,000 workers with high academic qualifications by 2006. To address this problem, it decided in 2001 to revive in modified form the Admission of Mainland Professionals Scheme. Another programme, the Admission of Talents Scheme, aims to attract to Hong Kong persons with expertise and skills not readily available locally.

There is no legal minimum wage in Hong Kong, and wage rates are essentially determined by supply and demand. Nevertheless, wages in Hong Kong are among the world's highest. Strikes and work stoppages are rare.

Some 95% of Hong Kong's 6.8m population is of Chinese descent. Mainland immigrants are expected to account for 57% of population growth over the next two decades as a backlog of eligible residents queues up to enter Hong Kong.

2.2 Employee benefits

Salaries in Hong Kong are still among the world's highest, although wage rates declined in 2002 as the economic slowdown squeezed companies' profits. According to results of a quarterly Labour Earnings Survey by the Census and Statistics Department, the average wage rate, as measured by the wage index, fell by 1.5% in nominal terms in September 2002 compared with a year earlier. About 51% of the companies surveyed reduced their wage rates over the same period, cutting guaranteed bonuses and allowance. Although 35% of companies surveyed recorded some increase in their average wage rates over the same period, the department attributed this to the retrenchment of lower-paid clerical staff. This drove up the proportion of relatively higher-paid workers rather than causing actual salary increases. The remaining 14% of companies surveyed reported almost no change in their average wage rates.

An employer must pay wages to his employees no later than seven days after the date when such wages become due. An employer that fails to comply with the law may be liable for a fine of HK$10,000.

The government has the authority to enforce minimum wages in industries in which remuneration is "unreasonably low", but it has never exercised this power. Prevailing wage levels are set by supply and demand. Wages are usually calculated on a time basis (for example, daily or monthly) or on an incentive basis (based on the volume of work performed). The pay period is normally 15 days for daily and piece-rated workers and one month for monthly rated workers. Most wages for unskilled and semi-skilled workers in manufacturing are piece-rated, though daily rates are also common. Monthly rated industrial workers are usually employed in skilled trades or in technical, supervisory, clerical or secretarial capacities. Monthly rates of pay are most common in non-manufacturing industries. Female workers tend to be paid less than their male counterparts.

The Mandatory Provident Fund (MPF) Schemes Ordinance was enacted in 1995 to provide a formal and compulsory system of retirement protection. It came into effect on December 1st 2000. The MPF provides a system of employment-related privately managed MPF schemes that accrue financial retirement benefits for members of the workforce.

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 in 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 the relevant employees of more than one employer, self-employed persons and persons with accrued benefits transferred from other schemes);
- An “employer sponsored scheme” (open only to the relevant employees of a single employers and its associated companies); and
- An “industry scheme” (established for employees of industries with high labour mobility, for example, the catering and construction industries).

Mandatory contributions are calculated on the basis of 10% of an employee’s relevant income, with the employer and employee each paying 5%. Self-employed persons also contribute 5% of their relevant income and may choose to contribute on a monthly or yearly basis. 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.

Mandatory fringe benefits for all factory workers include one rest day per calendar week and 11 paid statutory holidays per year. Under the Employment Ordinance, annual-leave entitlement is related to 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. An employee is eligible for maternity leave pay if she has worked under a continuous contract for no fewer than 40 weeks prior to the maternity 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. After 38 weeks of continuous employment, women are entitled to up to ten weeks of maternity leave at four-fifths of their normal salary.

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

Most firms voluntarily grant more generous benefits than those described above. Besides Sundays, there are 17 general holidays per year, which are granted with full pay to employees of banks and commercial organisations. May 1st has been made a public holiday. Larger industrial undertakings give 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. Most commercial concerns pay this bonus of one-month compensation at Christmas or Chinese New Year, but only to permanent and monthly workers. Some industrial establishments, such as those in spinning and weaving, pay this bonus to all workers.

2.3 Termination of employment

Under the Employment Ordinance, notice is required from either party unless there is just cause for dismissal. Wages may be paid in lieu of notice. Ordinarily, the amount of notice and compensation for dismissal or resignation varies with the type of job. For unskilled, semi-skilled and skilled labour (and sometimes for foremen), it is normal to give 7-14 days' notice. For office, professional and managerial staff, one-month notice is usually given (though for resignations, more senior professional and managerial staff may need to give three to six months' notice).

The Employment Ordinance imposes some limitations 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 when the employee is on paid sick leave. An employer is not permitted to dismiss his employee on grounds that the employee 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.

The Employment (Amendment 2) Ordinance passed by the Legislative Council in April 2001 made technical changes further preventing the termination of employment of pregnant employees or employees on a sick day. The amendment stipulates that an employer must pay compensation for dismissal of a pregnant employee within seven days after the day of termination; an employer who fails to do so will be liable for prosecution.

The Employment Ordinance 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 does not provide work for more than half the total number of normal working days in any period of four consecutive weeks or 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 HK$10,000 for every year of service. The maximum payment is 12 months' wages or HK$180,000 (whichever is less) immediately before dismissal or lay-off.

The Employment Ordinance 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 like those for severance payments.

2.4 Rules for foreign nationals

The government projects a shortage of as many as 120,000 workers with high academic qualifications by 2006. It has therefore revived the Admission of Mainland Professionals Scheme, first implemented in 1994. Under the scheme, employers would be allowed to bring in mainland professionals in specific areas with known shortages. Initially, this will apply only to the information-technology and financial-services sectors.

Employers, acting as sponsors, may submit applications directly to the Immigration Department without going through any intermediate mainland recruitment agencies, which had been required in the 1994 scheme. The government said in March 2001 that the modified scheme would meet immediate operational needs and would not be subject to any quota.

It continues to be difficult, however, to hire mainlanders for areas without known labour shortages. The workers need entry permits from the Hong Kong government.

The Admission of Talents Scheme, launched in December 1999, aims to attract persons from outside Hong Kong with expertise and skills not readily available locally. An employer, working for a Hong Kong-registered company, must submit the applications for prospective employees. Although it is a quota-free and non-sector-specific scheme, candidates specialising in information and communication technologies, electronics, advanced manufacturing technologies, product design and supply-chain management are favoured.

Government screening of applications appears to be tight. Only 237 of the applications submitted in 2001 were approved, according to the Immigration Department.

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 Labour 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 labour laws in Hong Kong. On completing their employment contracts, they must return to their places of origin. Employers found to have violated the labour laws in Hong Kong will be liable for prosecution. Those convicted are liable for administrative sanctions, including the withdrawal of quotas/approval to import and refusal of future applications.

As a general rule, persons other than those having the right of abode or right to land in Hong Kong must obtain a visa before coming to Hong Kong to live, work, invest, or take up employment or training. Applicants may submit their visa applications to the nearest Chinese diplomatic and consular mission in their place of residence. For visa applications other than from China and Taiwan, the applicants may send their applications to the Receipt and Despatch Unit of the Hong Kong Immigration Department directly or through the sponsor in Hong Kong. It normally takes four to six weeks to process an entry-visa application. The official policy is to grant a resident-working visa that is valid for one year, with annual extensions thereafter; however, extensions are often granted for two years.

The application for a working visa should include the following details: (1) name, address and telephone number of employer; (2) a copy of the applicant's service contract or letter of appointment with details of post, salaries and benefits; (3) job description; (4) academic and other qualifications; and (5) a statement of why the applicant's services are required and cannot be filled locally. For an entry visa application for investment in Hong Kong, the following additional information is required: (1) nature, size and financial undertakings of the proposed business activities; (2) the name, address and telephone number of any business partner in Hong Kong; and the (3) number of local and expatriate employees.

An employment visa is granted on condition that the applicant may take up employment only in the business or activity applied for. But the applicant's dependants are allowed to take up employment and are entitled to receive education in Hong Kong.

Hong Kong's immigration authorities follow an unofficial policy of refusing entry to unskilled or semi-skilled workers from overseas if qualified residents are available.

Hiring mainlanders is often difficult. Mainland workers may be sent to work in Hong Kong only if they have been issued an entry permit by the Hong Kong government. Workers are not allowed to switch jobs or employers without authorisation, and they are prohibited from staying on in Hong Kong after their contracts expire. Mainland Chinese students who have lived abroad for two years or more are allowed to accept offers of employment in Hong Kong.

There are signs, however, that the government may be easing travel restrictions between Hong Kong and the mainland, especially for businesspersons. To make it more convenient for mainland businesspersons to visit Hong Kong, multiple-entry business visas were extended, effective November 1st 2001, from six months to a maximum of two years (and each duration of stay was extended to 14 days from the previous seven days). Tung Chee-hwa said mainland authorities have also agreed to grant three-year multiple visas to visiting Hong Kong permanent residents who are foreign nationals. In addition, mainland authorities agreed to abolish the quota system for the Hong Kong Group Tour Scheme from January 2002. From January 2003, Hong Kong and the mainland instituted a 24-hour crossing border at one of the control points between Hong Kong and Shenzhen.

3.0 Business Regulations

3.1 Registration and licensing

Foreign licensing activity is limited in Hong Kong because of the SAR's relatively small manufacturing base compared with Asia's other newly industrialised economies such as South Korea, Taiwan and Singapore. A strong legal framework was put in place in mid-1997 with a new set of intellectual property laws brought into force, including the Copyright Ordinance, the Patents Ordinance and the Registered Designs Ordinance. The legislature passed a new, more modern Trademarks Ordinance in May 2000.

Foreign firms owning copyrights, trademarks and patents are beginning to see Hong Kong as a key location for licensing intellectual property in the region. Although Hong Kong's consumer market is small, it is sophisticated and more brand conscious than in many other Asian countries. Besides foreign brands, local brands like Giordano have become more recognisable. Many firms have built China licensing programmes from a Hong Kong base, as the SAR was for many years seen as a gateway to the mainland. An increasing number of firms, however, are beginning to work directly in China, following its accession to the World Trade Organisation in December 2001.

Several entertainment firms have established offices in Hong Kong, including The Walt Disney Company, Warner Brothers and Turner Home Entertainment (all of the US). These companies are integrating direct investment, franchising and licensing into their global marketing programmes. Sports/entertainment marketers, like the National Basketball Association of the US, also have established offices, and Hong Kong is a centre for Asian trade shows, including an annual toy show, Fashion Week and an electronics show.

Much of the contract manufacturing that once took place in Hong Kong has now shifted across the border into China's Guangdong province. For instance, 90% of toy production has moved out of Hong Kong, mostly to China. Some 100,000 Hong Kong firms now have crossborder manufacturing links, employing roughly 5m persons. Some local manufacturers are shifting their strategy, taking on licences and developing their own distribution networks. The concept of licensing is still fairly young in Asia, however, and many manufacturers are reluctant to pay royalties for brand names.

Technology transfer is relatively uncommon in Hong Kong, but the authorities are working to develop it into a technology centre.

The biggest concern of foreign firms licensing out of Hong Kong is piracy. Despite intensifying government efforts to crack down on copyright infringement, Hong Kong is still plagued by the transport of pirated compact discs (CDs) and video discs from China. The new Copyright Ordinance has significantly increased penalties for copyright violations, such as software and CD piracy and the faking of designer-label goods. An amendment to the ordinance--the Intellectual Property (Miscellaneous Amendments) Ordinance, passed in 2000 but made effective in April 2001--further enhanced copyright protection by criminalising the use of pirated computer software, film, television drama or music recording in business. The government has beefed up anti-piracy law enforcement, amid criticism of counterfeiting from the US and the EU.

The Customs and Excise Department is the sole enforcement agency responsible for protecting intellectual property rights. It investigates and prosecutes copyright offences relating to literary, dramatic, musical and artistic works, sound recordings, cinematography films, broadcasts and other published subject matter. It also takes enforcement action against commercial goods with forged trademarks or false labels under the Trade Descriptions Ordinance.

The private sector is also taking action against pirates. The Business Software Alliance, an industry organisation based in the US, is taking advantage of the new Copyright Ordinance to combat software piracy.

Under the new Copyright Ordinance, parallel importation of copyright works continues to be regulated. But criminal sanctions will be enforced against parallel imports only within 18 months of the first publication or release of the work anywhere in the world--to provide fair balance between the interests of various parties. Once the Legislative Council approves the Copyright (Amendment) Bill 2001, in 2003, the law will remove the civil and criminal liabilities related to parallel importation of computer software.

Intellectual property laws in Hong Kong

Major international conventions: Paris Convention (Trademarks and Patents), Bern Convention (Copyright), World Trade Organisation TRIPs (all branches of substantive intellectual property rights, plus enforcements), Universal Copyright Convention, Patent Co-operation Treaty.

Major laws: Copyright Ordinance (1997) as amended by Intellectual Property (Miscellaneous Amendments) Ordinance 2000; Patents Ordinance (1997); Registered Designs Ordinance (1997); Trademarks Ordinance (passed in 2000; will repeal all previous trademark laws and regulations when it comes into force in

January 2003); Copyright (Suspension of Amendments) Ordinance 2001; Prevention of Copyright Piracy Ordinance (1998); Lay-out Design (Topography) of Integrated Circuits Ordinance (1994).

Patents

The patents registry is not a registry of original registration. The new patents regime under the Patents Ordinance, enforceable since June 27th 1997, provides for the granting of independent, standard patents in Hong Kong based on the registration and grant of a patent by the Chinese Patent Office, the British Patent Office or the European Patent Office designating the UK.

Criteria. (1) novelty; (2) inventive step; and (3) industrial applicability.

Enforcement. Legally, protection is an absolute monopoly; the patent owner is not required to prove that the defendant copied the patented invention.

Duration. Maximum is 20 years. An eight-year patent has been introduced under the new Patents Ordinance, which suits inventions with a short commercial life and provides more flexible and economical protection compared with standard patents. The examination process for short-term patents is also less stringent.

Local re-registration fees. HK$1,800, including application and issuance of formal notice of re-registration, plus lawyers' fees.

Registered designs

Registered designs protect the outward ornamentation of a product. An eye-catching design applied to an article by means of an industrial process will be eligible for registration.

Enforcement. Legally, in an enforcement action, the owner of the right need not prove copying.

Duration. Maximum total of 25 years.

Local registration fees. None, but publication in the Official Gazette and one newspaper usually amount to at least HK$10,000.

The Layout Design (Topography) of Integrated Circuits Ordinance, enacted in March 1994, automatically protects the original layout designs of integrated circuits. It is not necessary to register topographies in Hong Kong.

Trademarks

Under the new Trademarks Ordinance passed by Hong Kong's Legislative Council in May 2000, defensive trademarks, collective marks and certification marks will be eligible for registration. The range of marks that can be registered as trademarks was broadened under the new law; for example, sound and scent may now be registered. Registration of marks in the Trademarks Registry confers proprietary rights and trademarks must be registered to obtain protection.

Eligibility. The following are not eligible for registration: marks devoid of any distinctive character; contrary to accepted principles of morality or likely to deceive the public; marks prohibited by Hong Kong laws; those consisting of a national flag, anthem, emblem or design. A trademark cannot be registered if it is identical to an earlier trademark and if its use, for certain goods and services, is likely to cause confusion.

Duration. Ten years, renewable for additional ten-year periods. (Under the previous trademarks laws, the term is seven years, renewable indefinitely on a "use it or lose it" basis for subsequent 14-year periods.)

Registration fees had yet to be prescribed by the Registrar of Trademarks in December 2002, but under previous laws, the following rates are charged: application, HK$1,400; certificate, HK$2,000; renewal, HK$4,100, plus lawyers' fees.

Copyrights

A new copyright regime was established on June 27th 1997 with the enactment of the Copyright Ordinance featuring an open system. Any original works created or published by anyone anywhere in the world qualify for copyright protection in Hong Kong. The scope of protection has been broadened to include exclusive recordings of public performances and copyright works made public in the Internet and digital environment. A new moral right was granted to protect copyright owners from derogatory treatment of their works.

Enforcement. Legally, in an enforcement action, the copyright owner must prove the defendant copied the copyrighted work.

Duration. Author's life plus 50 years; 50 years only where there is no human author (eg films by film studios).

Fees. None.

No approval is needed for licensing agreements, and no restrictions apply to the terms of a licence. No controls apply to remittances of fees and royalties or to tie-in clauses. A licensee may sue in its own name. A licensing agreement may not outlast the patent right for which it was granted.

Royalties are determined solely by the parties concerned. Arrangements that apply in the licenser's home country are generally acceptable in Hong Kong as long as the parties concerned conform to Hong Kong tax, exchange and other such requirements.

3.2 Price controls

Apart from the controls on charges for public transport, electricity and some residential rents, there are no significant price controls. The government has not announced any plans for new controls.

Hong Kong's rent-control system, introduced in the 1973 Landlord and Tenant Act and loosened in 1981, provides for tenure security and controlled rent increases for most tenants in private-sector post-war domestic premises. Hong Kong imposes no controls on commercial or industrial rents, apart from industrial estates.

3.3 Monopolies and restraint of trade

Partly because of the absence of antitrust competition laws, legal monopolies exist in the state-owned sector, transport services and utilities. Many companies operate under franchises awarded by the government.

In recent years, Hong Kong has opened the telecommunications market to free competition. The government made its first move in 1995, ending the local telephone monopoly held by Hong Kong Telecom and issuing four new fixed-line licences. The government reached agreement in 1998 with Hong Kong Telecom for the early termination of its exclusive franchise in the international call market. Since this market was opened in early 2000, the Office of the Telecommunications Authority (Ofta) has issued 16 cable-based and eight satellite-based telecoms services.

The government also issued six new personal-communication licences in 1996.

The Information Technology and Broadcasting Bureau issued licences for wireless fixed telephone network service (FTNS) beginning in May 1999 in order to encourage wireless transmission. FTNS uses local multipoint distribution services technology that can offer basic telephony and broadband Internet in areas in which Hong Kong Telecom used to hold a monopoly. In addition, a cable-television company was allowed to offer cable-modem services over its hybrid fibre/co-axial cable network.

At end-September 2002 there were 209 external telecoms-service operators in Hong Kong, according to the Information Technology and Broadcasting Bureau. Liberalisation in the mobile-phone market has driven down costs for customers and given them improved access. The mobile-phone services market is very competitive: there are six operators and 11 networks.

In June 2000 Hong Kong's Legislative Council passed the Telecommunication (Amendment) Ordinance 1999 to enhance competition safeguards, improve interconnection and access to telecoms services, streamline licensing procedures and provide the Telecommunications Authority with powers over certain technical areas. Under the legislation, the authority may determine directions relating to anti-competitive practices.

3.4 Intellectual property

Hong Kong undertook major changes in its intellectual property laws in the run-up to the July 1997 handover. The Copyright Ordinance, the Patents Ordinance and the Registered Designs Ordinance came into force on June 27th 1997, a landmark for protecting intellectual property laws in Hong Kong under Chinese rule. The Basic Law, Hong Kong's mini-constitution, holds the Hong Kong government responsible for formulating its own policies on, and the protection by law of, intellectual property rights.

The Legislative Council has passed several other laws since 1997 to protect intellectual property. It enacted the most important legislation, a new Trademarks Ordinance, on May 31st 2000, to modernise Hong Kong's trademarks law. It enhanced protection to trademark owners and simplified the application and maintenance procedures for registered trademarks. The Legislative Council approved the Trademarks Rules (a subsidiary legislation needed to make the new trademarks law effective) in December 2002. This approval cleared the way for the implementation of the new Trademarks Ordinance in January 2003.

The Prevention of Copyright Piracy Ordinance, passed in 1998, tightened licensing for the import of equipment used to make CDs, and it provides for the compulsory registration of optical-disc manufacturers and the mandatory printing of manufacturer source codes on all discs produced in the SAR. Stricter penalties were also imposed on those possessing counterfeit goods--up to eight years in prison and a HK$500,000 fine.

The Legislative Council passed the Intellectual Property (Miscellaneous Amendments) Ordinance in June 2000, effective from April 1st 2001, which adds more teeth to laws against software piracy.

In addition to the World Trade Organisation, Hong Kong conforms to the major intellectual property (IP) conventions. Its laws for protecting IP are considered effective, but its enforcement of those laws has not won unanimous praise. In protecting rights, the laws do not distinguish between residents of Hong Kong and foreign entities. A foreign corporation can arrange for coverage in Hong Kong and seek enforcement of its rights in the local courts.

The Trade-Related Aspects of Intellectual Property Rights (TRIPS) amendments to the IP laws made in 1996 under WTO requirements expand the definition of what can be trademarked. They provide for civil detention orders at the border to stop imports of infringing products and provide new anti-piracy tools to enforcement authorities.

Copyright law in Hong Kong is primarily derived from the Copyright Ordinance of 1997, which is in line with prevailing international standards on copyright protection. It protects the following: computer software; drawings; literary, dramatic, musical and artistic works; sound recordings, films and videos; and copyrighted works published on the Internet and in other digital environments. It also offers a new moral right to protect copyright owners against derogatory treatment of their works. An ordinance to protect the layout design of integrated circuits took effect in March 1994.

The copyright law provides for both criminal and civil remedies. To complement civil action by rights owners, Hong Kong imposes criminal sanctions on manufacturing, selling and distributing pirated works and counterfeit goods. In Hong Kong it is an offence to be in possession of an infringing article for the purposes of trade or business. The maximum penalties for possession of infringing copies of copyright works for trade and business purposes are a fine of HK$50,000 per copy and four years in prison for both first and repeat offenders. The penalties for possession of a plate for manufacturing infringing copyright works are a fine of HK$250,000 and four years' imprisonment on the first conviction. Repeat offenders are liable for a maximum fine of HK$500,000 and eight years' imprisonment.

The Intellectual Property (Miscellaneous Amendments) Ordinance went into force on April 1st 2001, giving the government wider powers to clamp down on corporations using pirated software in their daily operations. The law amends the Copyright Ordinance to allow the prosecution of any company for knowingly possessing pirated software in the course of business, even if it is not engaged in making the software concerned for sale. The term "business" as used in the Copyright Ordinance is not confined to commercial activities but can also cover educational, charitable or government activities. Such a copy might therefore be a pirated computer program, an unauthorised photocopy of a newspaper article, an unauthorised recording of a television programme, or an electronic copy or hard copy of a copyrighted work downloaded from the Internet without the authorisation of the copyright owner. In principle, the amending ordinance says that all copyrighted works should be treated equally and that they enjoy the same level of protection under the law.

Before the amendment, a firm could escape the law if it could prove that it was not actually dealing in the infringed goods concerned.

To address public concerns that the amendments hampered the dissemination of information in enterprises and teaching activities in schools, the Legislative Council passed the Copyright (Suspension of Amendments) Ordinance in June 2001. This legislation suspended until end-July 2002 the implementation of the April 2001 amending ordinance as it applies to certain criminal provisions in the Copyright Ordinance and subject to certain exceptions. For example, under the Copyright (Suspension of Amendments) Ordinance 2001, the ad-hoc photocopying of newspaper articles for internal reference purposes by enterprises is not an offence. Teachers may make multiple copies of copyrighted works in newspapers, magazines or books, and works downloaded from the Internet, for classroom use. However, the suspension does not apply to computer programs, visual or audio recordings of music or songs, television dramas or films--works that generally have substantial commercial value and are not normally considered "information" disseminated in enterprises or schools. Consequently, even a barbershop playing music recordings or videos containing television or drama from a pirated CD for the enjoyment of customers might be criminally liable. In July 2002 the Legislative Council extended the Copyright (Suspension of Amendments) Ordinance for another year, through the end of July 2003. Officials have said the government will probably make this ordinance permanent at the end of the extension period.

Another amendment to the copyright law, proposed to the Legislative Council in December 2001, will allow parallel importation of computer software, except software whose principal use is to be viewed or played as a movie, a television drama, or a musical audio or visual recording. The government said the move would increase competition and availability of products in the market, and make it easier for companies using pirated computer software to switch to legitimate products.

The Legislative Council passed another law increasing IP protection, the Intellectual Property (Miscellaneous Amendments) Ordinance (No. 2) in February 2001. The law made technical improvements to the Patents Ordinance and the Registered Designs Ordinance. For example, it allows the publication of patents and designs by electronic means, not only through the Government Gazette, and generally simplifies patent application procedures. It also enhanced Section 110 of the Patents Ordinance by providing 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 his right of priority to another party to apply for a short-term patent in Hong Kong based on the same invention.

The owners of IP rights may bring a civil action against infringers using "Anton Piller" and other court orders. (The Anton Piller order allows property holders to enter the infringer's premises and seize infringing goods.) These orders are used less often today than in the past, however, in part because they can be expensive to conduct and the government does not charge for this, according to Lovell White Durrant, a Hong Kong law firm specialising in IP rights. Detention orders are another tool for IP holders. These orders allow rights owners to seek Customs and Excise assistance in detaining the suspected import of pirated or counterfeit goods. The Copyright Ordinance allows courts to accept an affidavit as a basis of proof. Customs officials are now allowed to seize and forfeit suspected pirated goods.

Hong Kong's courts are generally capable of taking action against counterfeiters, but one major deterrent to prosecution is the high cost of litigation. A mere injunction to put a temporary halt to IP infringements can cost HK$250,000 in fees, according to Stephen Selby, the director of intellectual property. Further legal steps inevitably raise the fees even higher, so that the process can ultimately cost about HK$1m. Consequently, most IP lawsuits do not make it past the initial stages of filing a writ or getting an injunction, and they are eventually settled out of court. But some go to trial.

In October 2002 a Hong Kong judge ordered Able System Development, a computer retailer, to pay Microsoft (US) the equivalent of HK$4.5m in damages for the unlicensed use of the US software giant's products. The judge sided with Microsoft in the copyright-infringement lawsuit, alleging that Able, a licensed Microsoft retailer, had illegally pre-loaded unlicensed copies of the MS Office and MS Windows program onto computers it sold between 1996 and 1998.

Enforcement of Hong Kong's IP laws is under the jurisdiction of the Intellectual Property Investigation Bureau, which is part of the Customs and Excise Department. The bureau has significantly stepped up seizures and prosecutions in recent years. The Customs and Excise Department reported that it had seized 8.9m optical discs in 2001, up from 8.2m in 2000. The total value of discs seized in 2001 was HK$256m, up from HK$190m in 2000. The number of persons arrested for copyright offences fell to 1,686 in 2001 from 2,779 in 2000.

The bureau also seized HK$214m worth of counterfeit goods and products bearing false trade descriptions in 2001. A total of 581 persons were arrested in connection with these seizures.

Armed with the Intellectual Property (Miscellaneous Amendments) Ordinance, the bureau arrested ten persons from seven companies found to be using unlicensed computer software in their business during 2001. Up to HK$61,460 worth of infringing software was seized.

In March 2002 police arrested four men for allegedly operating a website that allowed subscribers to download pirated pop songs, movies, computer games and software files. The case was Hong Kong's first involving distribution of pirated items through subscription.

In addition to enforcement action, the Hong Kong government spends about HK$8m annually on anti-piracy education and advertising, according to Stephen Selby, director of intellectual property.

The US Trade Representative, expressing approval of Hong Kong's efforts to protect intellectual property, removed Hong Kong from its Special 301 watch list of IP rights violators in early 1999.

Despite these measures, pirated CDs, video CDs and computer software are widely available at shopping arcades and street vendors at a fraction of the cost of a genuine copy--sometimes even before the originals are released in Hong Kong. *The South China Morning Post,* for example, reported in July 2001 that computer arcades in Wan Chai, Mongkok and Shamshuipo were openly selling pirated versions of Microsoft's Windows XP operating system even before the software was officially released in October 2001.

The quality of illegal copies has deteriorated sharply in recent years, however, because almost all the high-volume manufacturing lines have been eliminated. Mr Selby said this equipment was too expensive to risk being seized. Investigators also said most of the pirated software available was being made in small orders using personal computers. In one police action, in September 2002, customs officials shut down two plants making counterfeit DVDs and seized pirated optical discs and equipment worth only HK$1.46m.

According to the Business Software Alliance, an anti-piracy industry group, the amount of pirated software used in Hong Kong declined slightly, to 53% of all software in use in the territory in 2001, from 57% in 2000. Companies were singled out as the worst offenders in this area. Total revenue lost to piracy amounted to US$164.04m, up from US$86.20m in 2000.

Hong Kong's intellectual property laws apply to e-commerce. Therefore copyright and trademark protection afforded to traditional products and services apply whenever these are traded or used on the Internet. The absence of legal precedents, however, makes it difficult to predict how disputes arising from infringement of intellectual property on the Internet may be resolved in future.

3.5 Mergers and acquisitions

The Hong Kong Code on Takeovers and Mergers is the main governing law here. In May 2002 the Office of the Telecommunications Authority (Ofta) proposed yet another law imposing restrictions on mergers and acquisitions in the telecoms sector. Under the Telecommunication (Amendment) Bill 2002, Ofta will have to pre-approve telecoms companies' share transactions involving stakes of more than 15%. The bill will also give the regulator the power to overrule transactions that sharply increase a firm's market share. Telecoms operators have questioned the new bill, arguing that Hong Kong's mobile-telephone industry is already the world's most competitive market: six operators fight for a stake in a population of 7m, with an 80% market penetration.

4.0 Foreign Investment

4.1 Foreign investment incentives

Hong Kong offers no special incentives to overseas investors or foreign-owned firms. Nevertheless, its free-port status, low tax rates, good infrastructure, relative freedom from government interference and substantial available capital make it attractive to potential investors and thus competitive with other countries in the region that do offer specific incentives.

4.2 Restrictions on foreign investment

The simplicity of procedures for investing, expanding and establishing a local company is a major attraction for foreign investment in Hong Kong. It is relatively easy to start a company: ready-made firms--known as shelf companies--are widely available and enable a businessperson to walk off a plane in the morning and start operating a firm in the afternoon. The government's special industrial-land policy features somewhat more complex rules, but it is still less demanding than the policies of many other Asian investment centres.

Controls on new investments are almost non-existent, and there are no exchange controls. However, new building construction requires permits, and polluting industries face increasingly strict controls. Moreover, pharmaceutical operations face strict rules on importation, manufacture, sale and distribution; the Department of Health oversees compliance.

There is no investment-approval procedure directed specifically towards foreign investors. All businesses must comply with the registration requirements of the Companies Ordinance and subsequent amendments. Except for state-owned activities, there are almost no limits on foreign investors. An exception is broadcasting and cable: foreign ownership of local broadcasting stations or cable operators may not exceed 49%. The handover did not affect the free movement of foreign equity. The Basic Law safeguards "free movement of goods, intangible assets and capital".

The government proposed to amend the Companies Ordinance in January 2002, based on the recommendations of the Standing Committee on Company Law Reform. The Companies (Amendment) Bill 2002 aims to enhance shareholders' protection, update the requirements on directorships, simplify the requirements for registration of foreign companies and make structural changes to modernise the ordinance. The bill seeks first to implement 17 of the recommendations of the standing committee; the other recommendations are to be implemented in phases. The bill had not yet been approved by the Legislative Council in November 2002 but will probably be enacted some time in 2003.

4.3 Exchange controls

Hong Kong imposes no controls on foreign exchange, and no restrictions on entry and repatriation of capital or on 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 the same way.

Hong Kong has tried to reassure nervous investors. For example, it has signed investor-protection agreements with trading partners to guarantee free transfer of funds.

In July 2002 the Legislative Council (Legco) approved anti-money-laundering legislation allowing the tracing and confiscation of proceeds derived from drug-trafficking and organised crime. In the same month, the Legco also enacted a new anti-terrorism law allowing authorities to freeze funds and financial assets believed to belong to terrorists, as required by UN Security Council Resolution 1373. Following passage of the new laws, in September 2002 the Hong Kong Monetary Authority (the central bank) ordered banks to submit report cards outlining the steps they had taken in the fight against terrorist financing.

4.4 Imports and exports

See Section 1.7.

5.0 Choice of Business Entity

5.1 Principal forms of doing business

The principal forms of business organisation are the limited-liability company (both public and private), branch, partnership and sole proprietorship. Most foreign investors form limited-liability companies, but in some cases they opt to form branches. All of these entities are subject to profits tax. A private limited-liability company is one that restricts that right to transfer its shares, limits and number of shareholders to 50 and prohibits any offers to the public of its shares or debentures. Companies that do not have these restrictions are public companies.

Company

A company can be incorporated with limited or unlimited liability, by registration with the Companies Registry under the Companies Ordinance. Most are limited companies. A limited company generally has a 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 price of the shares, or to the amount they have guaranteed. If a company enters into a transaction with another party and incurs a debt to that other party, the shareholders are not obliged to pay the debt, unless they specifically agree to do so.

Limited companies can also be divided into public companies and private companies. A private company is a company with 50 shareholders or less, the shares of which cannot be freely transferred or offered to the public for subscription. Only public companies can be listed on The Stock Exchange of Hong Kong.

Partnership

A partnership is formed where a person joins with other people to conduct business for profits. Partnerships may be set up for a certain period or for an indefinite period, or may be dissolved upon the completion of a specific venture if the partnership was initially conceived for that venture.

A partnership can be either a general partnership or a limited partnership. The liability of the partners for the debts of a general partnership business is unlimited. In a limited partnership, as organised under the Limited Partnerships Ordinance, there are one or more limited partners who may not take part in the management and cannot bind the other partners to his actions. The liabilities of these limited partners for the debts of the business are limited. There must be at least one general partner whose liability for the debts of the limited partnership is unlimited.

The English equitable principles of partnership apply in Hong Kong to the extent that they are not overruled by the Partnership Ordinance and the Limited Partnership Ordinance. All partnerships are required to obtain a business registration under the provisions of the Business Registration Ordinance. Limited partnerships must register as such with the Registrar of Companies, failing which they are deemed to be a general partnership with unlimited liability on each and every partner. Apart from that, there is no other registration requirement or commencement procedure.

The acts of any partner in carrying on the business of the partnership bind all the other partners. The rights and obligations of the partners in a partnership business are governed by their partnership agreement, which can be verbal or written, and the Partnership Ordinance or the Limited Partnerships Ordinance, as applicable.

Sole proprietorship

The establishment and operation of a business in the form of a sole proprietorship are relatively simple, as the owner of a sole proprietorship is personally entitled to all the profits and is responsible for all the liabilities arising from the business. Sole proprietorships are required to be registered under the provisions of the Business Registration Ordinance.

5.2 Branches

An overseas corporation that intends to set up a business in Hong Kong may register a branch office with limited liability. A branch is the same legal entity as its head office, and the establishment of a branch office is governed by Part XI of the Companies Ordinance. The overseas company must register its branch office within one month of commencing business. The procedure is quite simple and involves the preparation and submission of a list of required documents to the Hong Kong Companies Registry. If the Registrar is satisfied with the documents filed, a certificate of registration will be issued and the name of the company will be entered into the register of overseas companies kept by the Registrar.

5.3 Setting up a company

Solicitors or accountants provide services for incorporating and registering companies. Many international accounting firms have offices in Hong Kong.

All businesses engaged in activities in Hong Kong, whether incorporated locally or not, must obtain a Business Registration Certificate from the Inland Revenue Department within a month of commencing business. The certificate must be renewed annually with the department's Business Registration Office. The few exceptions include charities and some agricultural and fishing companies. An application is made by submitting a business registration form, together with the current annual fee, to the Business Registration Office. The government reduced the annual fee for one year, effective May 16th 2002 to March 31st 2003, to HK$600 from HK$2,250. Alternatively, businesses can pay three-year certificates at HK$3,200 (reduced from HK$5,200) for main businesses and HK$116 (previously HK$189) for branch businesses. The penalty for failing to register is HK$5,000 and one-year imprisonment. Business Registration Certificates are issued within 30 minutes of receipt of properly completed applications, if submitted over the counter. Application by post takes two days.

To be incorporated in Hong Kong, a new company must obtain a Certificate of Incorporation from the Companies Registry. The proposed name should first be checked for uniqueness at the Companies Registry. The following documents must be submitted to the Registrar of Companies: memorandum of association, articles of association and statutory declaration of compliance. The registrar also requires a covering letter stating the intended company name, the presenter's name, contact telephone number, fax number and address. The documents are filed, together with a fee of HK$1,720 (for companies having share capital) and the appropriate capital duty (at the rate of HK$1 for every HK$1,000 of nominal share capital, subject to a cap of HK$30,000 per case). For companies without share capital, the registration fee is HK$170-1,025, depending on the number of members stated in the articles.

The memorandum of association contains the full name of the company, a clause stating that the registered office is situated in Hong Kong, an outline of the firm's potential future activities (such as manufacturing), a clause stating that the liability of the members is limited and the amount of share capital. Capital duty in Hong Kong is payable on authorised share capital, so unless there are particular reasons for a high initial authorised capital, companies are generally incorporated with fairly low authorised capitals. HK$1,000 or HK$10,000 are most often used. All Hong Kong companies must at all times have at least two shareholders, and the subscribers will become the first two shareholders of the company upon incorporation. Shareholders may be individuals or companies, and there is no requirement that any of the shareholders be a Hong Kong resident.

The articles of association contain the rules on administration of the firm's election of its directors, classes of shares and the different rights attached to them, number of directors, quorum for general meetings and other internal matters. The Companies Ordinance contains a standard set of articles, known as Table A, which automatically becomes a company's articles of incorporation if it does not register its own articles.

The statutory declaration of compliance must be made either by a Hong Kong solicitor engaged in forming the company or by a director or secretary as named in the articles.

The government runs a Business Licence Information Service with a one-stop service to provide information on the licensing requirements for all business operations.

It normally takes the registrar six working days to process documents and issue a certificate of incorporation. A faster way to obtain a Hong Kong company is simply to purchase a "shelf company" (that is, one that has been incorporated but has never commenced business) from any of the firms of solicitors, accountants and specialist company formation agents. New directors are then assigned, and necessary changes are made to the name, memorandum and articles of association. More time (three to four weeks) is required if the name of the shelf company is to be changed. A shelf company should be completely "clean" when it is acquired; that is, it should never have traded or conducted any other activities and should not have incurred any liabilities or obligations. They are called shelf companies because they are formed by accountants or solicitors with no particular client in mind and then stored on the shelf in the office awaiting buyers.

The Companies Ordinance includes rules covering the conduct of company directors and auditors of firms listed on the stock exchange. Major provisions include the following:

Shareholding. Whether incorporated in Hong Kong or elsewhere, locally listed companies may repurchase their own shares. Company directors must generally obtain approval from a meeting of the company's members to authorise any allotment of shares. Members must give authorisation annually (a provision local directors have criticised as cumbersome).

Auditors. Every Hong Kong company must appoint an auditor every year at its annual meeting. Only persons qualified under the Professional Accountants Ordinance are recognised as company auditors. Moreover, there are specific procedures on the appointment and resignation of auditors and on penalties for corporate officers who make false statements to auditors. The annual audit fee is unlikely to be less than HK$8,000.

Company directors and secretary. Corporations may not serve as directors, except for private companies that are not subsidiaries of public firms. Directors must be at least 18 years old. Under the Companies (Amendment) Bill 2002, shareholders can remove directors by ordinary resolution passed by a simple majority at a shareholders' meeting, instead of a special resolution approved by a three-fourths majority.

Directors' disclosure. Directors must inform shareholders of the purpose of resolutions and reveal any personal interest in major transactions and any "material interest" in contracts.

Loans to directors. Directors may not obtain loans from the company except in the following cases: (1) loans between companies in the same group; (2) loans by private companies (except those belonging to a group of firms in which one or more of the members is listed); (3) loans to defray legitimate business expenses incurred; (4) loans to cover the purchase of a residence (limited to 80% of the property value); and (5) loans or loan guarantees of up to HK$500,000 by firms whose ordinary business includes lending money or guaranteeing credits. Under the Companies (Amendment) Bill 2002, the definition of "loan" was extended to embrace in generic terms the provision of financial assistance to directors.

Winding-up provisions. A limited company may be wound up by the High Court of Hong Kong if the company cannot pay its debts, if it has passed a special resolution for its winding up by the court or if the court thinks that it is just and equitable to have it wound up. When a company is ordered to be wound up, it generally puts an end to its capacity to dispose of assets, and the power to manage its affairs is transferred from the directors and members to the liquidators. The detailed legislation for companies winding up is in the Companies Ordinance and Companies (Winding-up) Rules (Chapter 32). A creditor or the company itself can present a winding-up petition to the High Court.

The registrar of companies may also petition to wind up a firm that has persistently breached its legal obligations. A solicitor is normally employed to begin the winding-up proceedings. The petitioner must deposit HK$12,150 to the Official Receiver when presenting the winding-up petition. After the winding-up petition has been presented and if the company's assets are in jeopardy, the petitioner through a solicitor can apply to the High Court of Hong Kong for the appointment of the Official Receiver or any other fit person as provisional liquidators of the company. This requires the petitioner to pay another deposit, of HK$3,000.

The Companies (Amendment) Bill 2002 proposed to increase the amount of minimum debt for which a petition for winding-up may be presented, from HK$5,000 to HK$10,000.

A corporate rescue bill, first drafted in 1996, proposed allowing firms that had become insolvent to apply for a 30-day moratorium, which could be extended to six months, during which no creditor could take action to apply to liquidate the firms. A provisional supervisor would then be appointed to negotiate with creditors and banks and try to find investors to inject fresh capital into the ailing companies in order to try to revive them. Passage of the bill has been delayed by controversy over whether the companies should pay out employee claims before applying for a corporate rescue.

Directors or officers of insolvent companies can be prosecuted for failing to keep proper books of account or other offences. Directors who are proven unfit to act as such can be disqualified by the court for 1-15 years. They can also be disqualified on conviction for company-related offences or for offences involving dishonesty. An amendment to the Companies Ordinance in 1999 introduced a new procedure to allow private companies that have no outstanding liabilities--with the unanimous consent of their shareholders--to apply to the Registrar of Companies to be de-registered. The amendment also introduced changes to provide for merger relief and streamlined the reporting of directors' details and other provisions to reduce the burden of compliance and help business.

Another amendment in 2000 streamlined filing requirements and further enabled companies to pass written resolutions and dispense with the holding of meetings.

An amendment in 2001 allowed a listed company to send a summary financial report to shareholders before a general meeting, instead of a set of documents that often runs to more than 50 pages.

The Companies (Amendment) Bill 2002, under consideration by the Legislative Council in November 2002, will also permit the formation of a company by one person; permit a private company to have a minimum of one director; prohibit the incorporation of a company limited by guarantee with share capital; and provide a timetable for completing transfers of shares of public companies. The bill also aims to simplify the paperwork for incorporation, change of company name and notification of the Registrar of Companies about consolidation of share capital, conversion of shares, appointment of receivers and other matters. Instead of statutory declaration, companies will be required to use only specified forms. The bill stipulates that court approval is not required where the reduction of share capital consists of a re-designation of the par value to a lower amount, subject to certain safeguards.

In August 2002 the Companies Registry awarded contracts for the development of the Integrated Companies Registry Information System (ICRIS), which is part of a larger project to establish a fully computerised operation. When ICRIS is completed in late 2004, customers will be able to file documents and incorporate companies electronically.

Additional licences or consents are required for certain types of companies, such as banks or authorised institutions (regulated by the Banking Ordinance), insurance companies (regulated by the Insurance Companies Ordinance) and securities dealers (regulated by the Securities and Futures Ordinance).

6.0 Corporate Taxation

6.1 Current taxation

Several Asian countries seek to attract investment with targeted tax breaks, but Hong Kong 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. These taxes apply only to income that arises in or derives from Hong Kong, though determining where income originates is not always a simple matter. Court rulings provide some guidelines for such "grey" profits. Foreign-sourced income is not taxable even if remitted to Hong Kong.

Hong Kong does not charge any direct payroll, turnover, value-added, gift or capital gains taxes. However, duties are charged on products like alcohol and tobacco.

With the passage of the Inland Revenue (Amendment) Bill in March 1998, the corporate profits tax rate was reduced to 16% (from 16.5%), the lowest rate among the major economies of the Asia-Pacific region. Unincorporated businesses continue to pay 15% of their profits in tax.

Despite a persistent budget deficit, the government has resisted suggestions to impose a 3% sales tax, one of the recommendations of an Advisory Committee on New Broad-Based Taxes formed in 2000 to review the tax system. Antony Leung Kam-chung, the financial secretary, said in October 2002 that a sales tax was not appropriate while the economy remained weak but might be introduced when the economy improves.

In addition to the sales tax, the committee presented 12 other tax options, including an increase in salaries and profit taxes and in property stamp duty and new levies. The proposed new levies include a capital gains tax; taxes on interest, dividends and worldwide income; payroll and social security taxes; a poll tax; and a tax on mobile telephones and signboards. In addition, a land and sea departure tax could be levied on travellers departing for the mainland. The committee said its consultant study, conducted by KPMG, confirmed that Hong Kong's general tax base was narrow.

Profits are now taxed by Hong Kong at 15% for unincorporated businesses and 16% for corporations. The tax is based on profits of the current assessment year.

Private and public companies are not differentiated for tax purposes, and no distinction is made between distributed and undistributed profits. Branches of overseas companies are taxed at the same rates as local subsidiaries.

However, any permanent or temporary resident of Hong Kong except a person younger than age 18 (unless both parents have died) 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 computed under personal assessment is less than the aggregate amount of the tax charged separately under profits tax, salaries tax and property tax.

The government introduced the Inland Revenue (Amendment) Bill in October 2000 to clamp down on elaborate tax avoidance schemes, but the proposed legislation had still not been approved in November 2002, because of strong opposition from banks, tax experts, accountants and lawyers. One of the bill's most controversial proposals is to deny a deduction for all interest payments arising from circular borrowing and the issuance of debentures between associated parties. No deductions will be made for interest payments if the taxpayer holding the debenture or instrument is, in fact, the issuer itself or one of its associates. The proposal was made to discourage taxpayers from issuing debentures that are bought by offshore associates--effectively increasing deductions for interest payments. Critics have warned, however, that the proposal could damage genuine commercial financing opportunities, creating difficulties for businesses to consider cost-effective sources of finance.

The bill also proposes to amend the Inland Revenue Ordinance to overcome a December 1999 ruling by the Court of Final Appeal that deemed royalty payments attributable to goods manufactured outside of Hong Kong non-taxable. The ruling meant that only royalty income from the sale of goods made in the SAR could be deemed to be profits arising from the use of a trademark in Hong Kong and thus liable to tax.

6.2 Capital gains taxation

Capital gains are not taxable. However, the gain on disposal of assets such as real property or shares may be subject to profits tax if the disposal constitutes a transaction in the nature of trade.

6.3 Profit repatriation

Hong Kong does not impose tax on dividends. There is also no withholding tax requirement on profits repatriated to the home country.

6.4 Shareholder financing

Unlike many Western countries, the rule of thin capitalisation does not apply in Hong Kong. The issued share capital can be as low as HK$2. There is also no withholding requirement when the company remits interest payable to non-residents who may or may not be shareholders.

6.5 Deductions

For capital expenditure incurred on the construction of industrial buildings and structures, the initial depreciation allowance is 20%, taken in the year of the expenditure. An additional 4% is allowed annually thereafter, until the total expenditure is written off. If the asset is disposed of before this, a balancing allowance or charge equal to the difference between the disposal price and the written-down value on disposal may arise.

A purchaser (other than the original investor) of a newly constructed industrial building is also eligible for the initial 20% depreciation allowance. For commercial buildings (which do not qualify as "industrial buildings"), the annual depreciation allowance ("rebuilding allowance") was increased in April 1998 to 4% (from 2%) of the cost of construction. Capital expenditure on renovating or refurbishing business premises may be deducted over five years in equal instalments, starting in the year when the expenditure was made.

The Inland Revenue (Amendment) Ordinance of April 1998 allowed an immediate write-off in full of expenditure on plant and machinery specially related to manufacturing, and on computer hardware and software.

The initial depreciation allowance for the cost of plant, equipment and machinery is 60%. Thereafter, there are prescribed rates of depreciation that apply to the declining balance. Items qualifying for the same rate of annual allowance are grouped under one "pool": air-conditioning plant, 10%; individual air conditioners, 20%; electronic data-processing equipment, 30%; furniture and fixtures, 20%; sulphuric- and nitric-acid plant, 30%; petrol-powered vehicles, 30%; textile and clothing machinery and plant, 30%; and plastic-manufacturing machinery and plant, 30%. For plant and machinery not specified by the Inland Revenue, the usual rate is 20%. A copy of the list is included in the Inland Revenue Rules, available from the Hong Kong Government Publications Centre at Admiralty.

A balancing allowance is available only on cessation of a business to which there is no successor. A balancing charge can 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 revalued, but depreciation is always based on historical cost.

6.6 Loss relief

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 counteract the purchase of an unrelated loss company for the sole or dominant purpose of obtaining a tax benefit.

6.7 Consolidation

No provisions exist in Hong Kong for filing consolidated returns with respect to groups nor do provisions exist for loss relief with respect to profits and losses of different members of the same group.

6.8 Reorganisations/Mergers & acquisitions

See Section 3.5.

6.9 Foreign-earned income

Hong Kong signed a tax treaty with mainland China in February 1998 to eliminate double taxation between the Special Administrative Region (SAR) and the mainland. The new arrangement went into force on April 1st 1998 in Hong Kong and on July 1st 1998 on the mainland. The treaty ensures that the profits of Hong Kong firms without permanent establishments in China are taxable only in Hong Kong. Those companies with branches on the mainland may be taxed there, but their tax liability will be restricted to profits attributable to their permanent establishments. Many Chinese state enterprises without permanent establishment in Hong Kong no longer have to pay tax in Hong Kong.

Under the agreement, projects or supervisory activities conducted by a Hong Kong-based enterprise on the mainland will not be subject to mainland tax. Income from aviation, shipping and land transport operations conducted by Hong Kong enterprises on the mainland is also exempt from mainland tax, with no time restriction. Hong Kong residents providing services on the mainland are not required to pay mainland income tax if they stay fewer than 183 days (increased from the previous 90 days). Hong Kong will provide tax credit relief for Hong Kong residents subject to taxation on the mainland. The new tax treaty benefits Hong Kong residents and companies, since mainland tax rates can be three times higher than in the SAR. For instance, the standard profits tax rate is 33% in mainland China.

The tax deal may also be viewed as an incentive for local companies to expand their mainland operations and pave the way for other crossborder agreements to integrate the two economies.

Hong Kong's role as a base for multinational companies doing business in China used to be threatened by the double-taxation situation. It was more economical for companies to operate from one of the 54 other countries that have a treaty with China. Singapore, for example, exploited the absence of a tax treaty between Hong Kong and China to promote its image as a base for mainland operations.

Hong Kong has no general tax conventions with any other country. This greatly helps to maintain confidentiality about the ownership and use of a Hong Kong company. However, Hong Kong has agreements with China, the Netherlands, the UK and the US for mutual tax exemption on shipping income. The agreement with the Netherlands, signed in October 2000, exempts owners of ships from Hong Kong from paying tax levied on cargo loaded in the Netherlands and vice versa.

For non-Hong Kong residents, Hong Kong income may be subject to (double) taxation in their resident countries. However, many countries (like the UK or Australia) offer their residents unilateral tax relief on incomes sourced in Hong Kong.

Hong Kong has double-taxation relief arrangements in air transport income with Bangladesh, Belgium, Canada, mainland China, Denmark, Estonia, Germany, Israel, Korea, Mauritius, the Netherlands, New Zealand, Norway, the Russian Federation, Sweden and the UK. Under the agreements, airlines are taxed at the rates of their home countries for worldwide income and are not taxed in destination countries.

6.10 Transfer pricing

A local firm may deduct from taxable income various forms of payment to a foreign affiliate--including payments for direct purchases, shared expenses and management fees. Such deductions usually face no special rules or scrutiny.

A transfer of certain allowable head-office administrative expenses by means of a charge to a local branch or subsidiary in Hong Kong is treated as a deduction for Hong Kong tax purposes.

However, if the Inland Revenue Department finds that where a non-resident conducts business with a resident with whom he is closely connected and the course of such business is so arranged that it produces to the resident either no profits that arise in or derive from Hong Kong or less than the ordinary profits that might be expected to arise in or derive from Hong Kong, the business conducted by the non-resident in pursuant of his connection with the resident shall be deemed to be carried on in Hong Kong, and such non-resident shall be assessable and chargeable with tax in respect of his profits from such business in the name of the resident as if the resident were his agent under section 20 of the Inland Revenue Ordinance.

6.11 Other taxes

On their initial registration in Hong Kong, new motor vehicles are taxed as follows: 40-60% of cif value for private cars, depending on value; 40% for motorcycles; and 4% for lorries and buses. Used vehicles are subject to a separate, much lower regime. A nominal declaration fee is charged on imports, exports and re-exports, and clothing exports are subject to a levy of 0.03% of fob value in order to support industry-training schemes.

Owners are subject to tax on real estate leased to a tenant. 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 an allowance of 20% for repairs and maintenance. By law, property owners must keep detailed rent records for at least seven years; they must notify the Inland Revenue within one month of the sale or transfer of property. If a company includes income from property in its income for profits tax purposes, it may deduct the amount of property tax paid from the amount of profits tax due.

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

Stamp-duty rates were raised, effective April 1st 1999, on property purchases costing more than HK$3m. The government deferred payment of the stamp duty until completion of a property deal, instead of charging duty at the time of the signing of the sale and purchase agreement.

Stamp duty on share transactions was cut to 0.2% (from 0.225%) from September 2001. The duty is shared equally by buyer and seller. Regional derivative products were exempted from stamp duty from May 1st 1998. The Stamp Duty (Amendment) Ordinance has allowed stamp duty exemptions for some transactions in options, warrants and convertible bonds since April 1st 1998.

Other levies include a hotel accommodation tax (3%), a duty on bets (12-25%) and an estate duty. The government increased the Air Passenger Departure Tax, levied on all air passengers departing Hong Kong, in April 2001, to HK$80 (from HK$50).

No turnover or sales taxes are levied, and the only excise taxes are on alcoholic beverages, tobacco, methyl alcohol and hydrocarbon oils. In April 2002 the government increased the duty rate on wine from 60% to 80%, and cut by 40% the quantities of duty-free tobacco that Hong Kong residents may bring to the SAR. Quantities for duty-free wine were reduced by 25%.

6.12 Tax compliance and administration

Persons, including corporations, partnerships, trustees and bodies of persons carrying on any trade, profession or business in Hong Kong, are subject to tax on all profits (excluding profits arising from the sale of capital assets). If a person sells his flat or any property as part of a profit-making scheme, it will be regarded as a business and he must pay tax on any profit made. The assessable profits (or adjusted loss) are the net profits, or loss--other than profits (or loss) arising from the sale of capital assets--for the basis period, arising in or derived from Hong Kong.

Income is considered sourced where the operation that generates it takes place. Thus all profits arising in or deriving 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. In 1996 Hong Kong formally exempted overseas mutual funds, unit trusts and collective investment schemes from Hong Kong tax on profits from trading and interest, extending an exemption already enjoyed by domestic investment vehicles. Interest accruing to a corporation conducting business in Hong Kong is taxable unless the credit is made available to the borrower outside Hong Kong.

Special formulae apply to computing taxable profits for the airline, shipping and insurance businesses. For example, profits of life insurance companies are assumed to be 5% of the premiums received from Hong Kong, unless the insurance company makes the (irreversible) choice to be assessed on the basis of actuarial reports. The Inland Revenue (Amendment) Bill approved in April 1998 granted a 50% profits tax concession for the offshore business of reinsurance companies.

In addition to the above criteria, income from the following activities is subject to profits tax: (1) fees from the exhibition or use in Hong Kong of cinema, television, film or tape, or any sound recording; (2) sums received for the transfer of certain rights to receive income from property; (3) grants, subsidies or similar financial assistance connected with a business conducted in Hong Kong; (4) fees received for rental of movable property in Hong Kong; (5) Hong Kong-sourced profits from the sale of or on the redemption of a certificate of deposit or bill of exchange; and (6) royalties from the use of or right to use certain types of intellectual property in Hong Kong.

Income claimed to have a foreign source remains a subject of considerable debate. There is particular confusion about the source of profit for trading firms known as "re-invoicing" companies, which take a passive role in executing transactions but are sometimes held liable for Hong Kong tax. Tax authorities consider income taxable if the Hong Kong company or branch makes either purchase or sales contracts for goods. But the High Court rejected that test in a 1996 case, CIR v Magna Industrial Company; it said instead that these trading firms needed to be examined on a case-by-case basis, leaving the issue unclear.

Banks and deposit-taking companies are taxed on interest income from offshore lending activities if the interest arises from conducting the business in Hong Kong without the substantial intervention of a branch located elsewhere.

A non-resident's local agent in Hong Kong may be assessed for profits of the non-resident, whether or not the agent has the receipt of the profits. Resident consignees must furnish quarterly returns to the Inland Revenue Department showing the gross proceeds from sales on behalf of their non-resident consignors and pay a sum equal to 1% of such proceeds, or a lower agreed sum, usually 0.5%. When a non-resident conducts business with a resident that results in less-than-expected ordinary profits, the business may be treated as conducted in Hong Kong by the non-resident through the resident as agent. If the accounts of a non-resident firm do not disclose the true profits of the firm's branch in Hong Kong, the branch's profits will be taken as a proportion of total profits equal to the proportion of the branch's turnover to total turnover. Furthermore, if the true profits of a business conducted by a non-resident in Hong Kong cannot be readily ascertained, the profits may be computed as a reasonable percentage of turnover.

Partnerships are treated as taxable entities in Hong Kong, and shares distributed to partners are not taxable. Joint ventures are generally treated as a partnership by the Inland Revenue Department.

Expenses incurred while earning income are allowed as deductions. 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, scientific research expenditures, 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 10% of assessable profits). The deduction for foreign withholding tax on interest income subject to Hong Kong profits tax was extended in 1997 to overseas companies operating a branch in Hong Kong.

Tax losses may be carried forward indefinitely. A corporation conducting more than one trade may use losses in one to offset profits in another. If a company participates in a partnership of fewer than 20 individuals that earns a tax loss, the company may deduct its share of the loss from its own taxable profits.

Tax returns are due annually on March 31st (the end of Hong Kong's tax year), reporting income in the company's latest completed fiscal year. With the return, companies must pay a provisional profits tax at a 16% rate of the previous fiscal year's profits. This payment is credited against the final profits tax, which is payable during the following fiscal year on assessment by the authorities. Any excess payment is applied to the provisional profits tax payable for the following year.

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

7.0 Deloitte & Touche Offices In…

7.1 Hong Kong

Deloitte Touche Tohmatsu, a leading global professional services organisation, delivers world-class assurance and advisory, tax and consulting services through its national practices. In today's world of dynamic change, Deloitte's closely linked teams of industry and tax specialists monitor key tax and business issues around the globe, to provide knowledge to clients wherever they do business. This approach, enabled by innovative and award-winning technology, is essential to our "global, yet local" service.

To find out how Deloitte Touche Tohmatsu's tax professionals can help you in your part of the world, please contact us at one of the offices listed below, or through the "contact us" button on www.deloitte.com.

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