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Issue 13

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1. The New Zealand- Hong Kong Free Trade Agreement and its implications for New Zealand exporters and traders.

We do not propose to comment on specific provisions in the New Zealand – Hong Kong Free Trade Agreement ("FTA") signed in March 2010. Its impact, in our view, in the areas of reduction of tariffs and duties for NZ exporters, (HK is a free port with limited products subject to duty) is limited. However, the FTA, recent taxation reforms in NZ, and a proposed double taxation agreement with Hong Kong has reinforced the advantages that traders, exporters and investors may gain by establishment of an office or corporate presence in Hong Kong (" HK");

Other options may exist if the intention is to trade direct with China or manufacture there, although the ability for an offshore company to retain what previously would have been controlled foreign company profits ("CFC profits") free of NZ tax (until remitted back to NZ) means that a HK or other offshore company may offer a more convenient marketing and trading vehicle than any entity set up in China and owned direct by the NZ entity in NZ;

It may be useful to briefly summarise some of the structures that NZ exporters and traders may utilize. Much will depend on whether the intention is to manufacture in China (whether through a joint venture, wholly owned foreign enterprise or licensing of a local manufacturer), or trade product sourced from NZ or China for sale in the international market.

Branch in Hong Kong: An obvious option is to simply establish a branch of a NZ company in HK to market NZ products in Hong Kong and China or acquire HK/ China products for sale to NZ or internationally. A branch of a foreign company registered in Hong Kong can buy goods in Hong Kong (but not sell them in HK) or market products from NZ and will not be classed as carrying out any taxable operations in HK;

1.4.1 **Whether To Register as a Branch:** The initial decision for a NZ business is whether register as a branch or a wholly owned subsidiary. In the past this decision may, in some cases, have been determined by NZ tax considerations, particularly as Hong Kong had few, if any, double tax treaties with OECD countries. Where initial set up expenses are high it may be that these, and initial losses, can be deducted at the NZ end when a branch is established. However, in the longer term, the advent of the new offshore tax regime and the possible advantages from the intended HK- NZ Double Tax Treaty, may

make a wholly owned subsidiary more attractive. Individual advice will be required but summarizing advantages and disadvantages of a branch operation as follows:

(a) **Advantages of a Branch:**

(i) **Stamp duty**- HK stamp duty on a transfer of shares may be avoided, if the trading entity was a wholly owned subsidiary of the NZ parent;

(ii) **Easier Administration**- it may be that with say a BVI (British Virgin Islands) company and other offshore companies with their local jurisdictions laws, compliance with securities laws in HK, raising capital, general administration, may be avoided and be more simple and cheaper;

(iii) **Names**: A NZ or offshore company may be able to use a name prohibited in HK , such as using the name " Trust" in its name, or not using the name " Limited " which is compulsory.

(iv) **Corporate Mobility**: A HK company cannot re- domicile itself and must be wound up, whereas say a BVI company can leave the place of its registration and register in an other jurisdiction without winding up.

(v) **Salaries Tax**: An employee of a branch operation in Hong Kong can claim exemption on salary earnt while outside Hong Kong whereas a director or employee employed by HK Company and resident in HK may not generally claim such an exemption.

(b) **Disadvantages of a Branch**:

(i) **Extra Administration**: Two sets of annual administration and other fees will have to be paid, the laws of both jurisdictions will have to be complied with.

(ii) **Disclosure and Documentary Requirements**: Registration of a branch can be an expensive, complex and time consuming procedure. Full copies of all company documents must be certified by a notary public, application papers prepared, details of all directors given, a local HK individual resident in HK must be appointed an agent to accept service of documents in HK, a copy of the latest accounts must be filed, and ongoing annual accounts must be filed unless there is an exemption granted on the basis that the local law of the company grants an exemption from this requirement. The application and the annual exemption must be prepared by a local HK lawyer. Annual returns need to be filed, as well as annual audited accounts in HK if the company conducts HK business, and any changes to directors, secretary must be notified to the HK company registry within 21 days.

(iii) **Costs**: Legal and accountancy costs may be higher for registering a branch.

<u>Registration of a Subsidiary in Hong Kong</u>: The advantages of Hong Kong and using a Hong Kong Company to operate a business in Hong Kong are relatively well known and need not be repeated here. A full summary of the advantages and associated costs are set out in Annexure 1 attached to this Newsletter. Registration of a subsidiary may well offer advantages in the following situations;

Taxation Advantages for the NZ company: Although initial losses in a HK subsidiary may not be able to be set off against the NZ parent company's profits, there would be other tax advantages:

(a) under the new NZ offshore tax regime, active trading profits, under the amendments to the CFC rules, from a company established in Hong Kong, will not be subject to NZ tax as compared with a NZ company simply exporting from NZ;

(b) so long as pricing is at arms length to comply with NZ IRD requirements, product sold to a HK subsidiary may well be priced so as to capture profits arising from an on sale of the product to China or other international customers;

(c) in the absence of a full scale office in Hong Kong, advantage may still be taken of Hong Kong's territorial tax system to capture the profits free of Hong Kong profits tax. We will deal with some of the complications of undertaking what are known as re-invoicing operations in Hong Kong later in this Newsletter. Basically, if a transaction is conducted outside Hong Kong or in another country, and documentation is also signed outside Hong Kong, the profits arising from the transaction are not taxable. For instance, operations of a subsidiary in say Malaysia will not be taxable in Hong Kong. Re- invoicing transactions and capturing the profits in Hong Kong for corporate groups is common as are management charges inter- group with a service fee mark up. Many international companies base the holding company for their Asian operations in Hong Kong for this reason;

(d) the HK subsidiary may play a role in supervising the operations of either a China manufacturing subsidiary or import and processing operations carried out in China by a separate China entity. Profits from the product sourced from China and sold internationally may qualify for a 50% tax reduction from HK profits tax. We deal with this issue later in part 2 of this Newsletter;

(e) while in many instances HK's territorial system will mean that profits of a subsidiary will not be subject to tax, increasingly the HK IRD has sought to tax operations hitherto not deemed to have been carried out in HK(see following article in part 2 of this Newsletter) and the implications of a Double Tax Treaty between HK and NZ, while not yet known, may be of assistance.

    Of particular interest will be what companies will be deemed to be resident in HK for the purposes of operation of the NZ-HK Treaty. Hong Kong has no definition of a " tax resident", a concept referred to in the model convention relating to members of the OECD. Some guidance may be had by reference to the HK- Luxembourg Tax Treaty and the latest treaty with Austria. The Luxembourg government indicated in its comments on the Treaty that the Hong Kong territorial taxation system should not hinder the application of the treaty. However, a 'place of effective management' test would be of material importance in order to determine whether the subsidiary will be considered as a Hong Kong resident. Accordingly, under the Luxembourg Treaty a subsidiary or the branch of a foreign company holding a meeting in Hong Kong or conducting effective business operations there will be considered resident.

Under the Treaty with Austria, residents of HK are defined and include:

(i) any individual who ordinarily resides in the Hong Kong Special Administrative Region; (ii) any individual who stays in the Hong Kong Special Administrative Region for more than 180 days during a year of assessment or for more than 300 days in two consecutive years of assessment one of which is the relevant year of assessment; (iii) a company incorporated in the Hong Kong Special Administrative Region or, if incorporated outside the Hong Kong Special Administrative Region, being normally managed or controlled in the Hong Kong Special Administrative Region.

Under both the above treaties provision is made for a credit to be given in the other country for any tax paid by the resident and we would expect the NZ- HK Treaty to adopt the same rules.

(f) In summary, in view of the major changes to the CFC rules and the projected NZ- HK Double Tax Agreement, a NZ company conducting international trade would be well advised to consider the set up of a wholly owned subsidiary in Hong Kong. However, costs to set up a subsidiary and annual audit and other costs must be considered to see if whole exercise is cost effective.

2. Using Hong Kong for re- invoicing and trading -do not let the Hong Kong IRD spoil the party.

As alluded to above, the HK IRD have, over the last 5 years, become increasingly suspicious and inquisitive over the operations of Hong Kong companies utilized by foreign interests to provide re- invoicing services so as to trap profits in Hong Kong free of Hong Kong profits tax. The typical case involves acquisition of product from the parent company or its subsidiary say in NZ or some other country, issue of invoices to the buyer by the HK company, payment to the bank account of the HK company of the marked up product cost, with perhaps a payment to the HK company by the parent for provision of its services;

While in principle the HK IRD recognizes this kind of trading operation by what is known as a " cash- box" company, failure to observe management and structural issues will mean an investigation by the IRD and searching questions when the first accounts of the HK company are filed and an offshore profits exemption claimed;

Whether the profits of a HK subsidiary set up to provide invoicing services to the NZ parent are liable to profits tax will depend on whether the company can be classified as a " cash box " company with no effective operations in Hong Kong giving rise to the profits generated. The HK IRD publishes interpretation and practice notes("DPIN"). DPIN 21 deals with locality of profits. While not legally binding and not always truly reflecting the latest case law, they are a useful introduction to the several profits tax issues and we summarise them briefly below;

where trading in commodities and goods are involved the IRD considers that:

profits are taxable in HK where the contract is signed in Hong Kong;

profits are not taxable in Hong Kong where both the purchase contract and the sale contract are signed outside Hong Kong. Accordingly, where a Hong Kong company is used to capture the difference between a purchase and an onward sale at a profit, no tax should arise where directors resident outside Hong Kong sign the contracts, although preferably a duly appointed agent should do so;

Where either the purchase contract or the sale contract is signed in Hong Kong, the IRD presumes that the profits are taxable unless the " operations test" determines otherwise;

Sale to a Hong Kong customer usually means the profits are taxable in Hong Kong but that presumption easily displaced;

Goods purchased from a Hong Kong manufacturer or supplier usually means the purchase contract was made in Hong Kong;

Where effecting of contracts does not require travel outside Hong Kong but they are signed by fax etc, the IRD regards them as having been made in Hong Kong. Note that under the operations test, appointment of agents to affect a contract may well mean the contract was made outside Hong Kong. Proof that employees and agents habitually sign contracts outside Hong Kong backed up with documentary evidence such as agency contracts, employment contracts , will be needed to establish that contracts are made ex- Hong Kong. Receipts for hotel and travel expenses will need to be produced;

The very common situation of issuing or accepting an invoice (but not an order) to or from a Hong Kong/ Non- Hong Kong customer or supplier, whether related or not, arranging letters of credit, operating a bank account, and maintaining accounting records, will mean that a " cash –

box “ re- invoicing company is being operated in Hong Kong. The profits from the operations are not taxable. Care is needed to ensure that any directors in Hong Kong, whether nominee or otherwise, do not stray into areas of negotiation of contracts so that the HK IRD has cause to argue that the brains of the operation and all administrative activities are in fact being carried on in Hong Kong;

The IRD does not accept apportionment of profits is possible when dealing with trading profits;

If HK agents are properly appointed and they conduct business on behalf of the HK company outside Hong Kong in accordance with the typical structure plan referred to in Annexure 2 then profits should not be subject to profits tax subject to the following qualifications:

(a) it would be better if an independent agent outside Hong Kong was appointed to sign contracts if that is practical. The danger in our experience is that it is difficult to avoid preliminary correspondence between the agents based in HK and the buyer and if that is interpreted as negotiation of an order, it may have a HK source. As well, staff employed by the HK company may well have their roles confused by the IRD and it would be essential that their role be referred to in their employment contracts. In short, the role of the HK company must be confined to issuing invoices in relation to contracts already concluded and signed by agents outside Hong Kong, as well as the other duties mentioned in Annexure 2;

(b) we have mentioned above that proper appointment of agents is desirable. While a recent leading case in the HK Court of Final Appeal (IRD v Barings) emphasized that formal appointment of agents might not always be necessary and that independent contractors may act for a Hong Kong company as well, it is in our view essential to have formal documentation either in the form of an employment contract delegating agency power or a formal agency agreement;

(c) If execution of contracts takes place outside HK that is fine, but an order accepted or negotiated by the agent in or outside Hong Kong and faxed to HK company to sign would not be acceptable;

(d) so long as the NZ directors of the HK Company do not resolve at Hong Kong directors meetings to conclude or sign particular contracts and sign documentation in Hong Kong implementing such decisions, meetings in Hong Kong should be in order, although it would be preferable to have meetings of directors held outside Hong Kong;

(e) care is needed where nominee directors are appointed as their role and authority in the conduct of operations must be strictly confined to issuing invoices with no involvement in negotiating orders;

<u>PRC processing operations conducted through the HK subsidiary:</u>

It has become increasingly common for foreign companies, including NZ companies we have advised, to establish processing operations in China and to license a china manufacturing or products producer (“ China Co”) to produce product for sale to international buyers or for sale to NZ customers;

A critical issue, involving mixed questions of tax and law, is how to manage and inject funds or grant IP rights to China Co, and what entity should be engaged in sale of the product;

As an example, raw materials and/or IP could be sourced from NZ through a HK company and injected into a PRC processing operation. HK company might then sell finished products to buyers outside Hong Kong;

Just how the HK company would participate in the processing operation and be involved in selling the finished product needs to be carefully thought out if it is intended to try and capture profits on sale free of HK tax in the HK company. If the HK company is to be involved in orders, retains title to the products and then sells them, finances the processing, and pays fees for the processing it seems inevitable that substantial involvement by the HK company may be involved. Payments might be made from the HK bank account of the HK company and staff may be involved in day to day supervision of the processing operation. Staff may of course simply be nominee directors based in HK.Typical questions asked by the HK IRD are how were the goods procured and stored? How were the sales solicited? How were the orders processed? How were the goods shipped? How was the financing arranged? If any of these activities are carried on by the HK company profits may well be taxable in Hong Kong, although a 50% apportionment may be possible if it is a Contract Processing operation;

The above type of operation may be classed as Contract Processing by the HK IRD;

In Contract Processing, the Hong Kong enterprise engages a PRC entity to process goods in PRC on a cooperative basis. The processing agreement, which has to be approved by the relevant PRC authorities, typically stipulates that the Hong Kong enterprise shall provide equipment and raw materials at no consideration, provide technical assistance, and pay a processing fee to the PRC entity. The PRC Entity is required, on the other hand, to provide factory premises and labour, to process the raw materials provided by the Hong Kong enterprise into finished goods and to handover the processed goods to the Hong Kong enterprise. Apart from the obligations under the processing agreement, the Hong Kong enterprise also has other activities in Hong Kong, such as arranging purchase and sale and carrying out design and technical know-how development;

Under Contract Processing arrangement the PRC entity takes no ownership title to the raw materials and the processed goods throughout the course of processing. All processed goods have to be exported back to the Hong Kong enterprise. Recognising the involvement of the Hong Kong enterprise in the processing activities performed in the PRC under this kind of arrangement, the IRD accepts, as stated in DIPN No. 21 that the profits on the sale of the goods in question can be apportioned on a 50:50 basis. However, the DIPN has made it clear that apportionment of profits does not apply to cases where the manufacturing process in the PRC is contracted to a sub-contractor with minimal involvement of the Hong Kong business;

Reference may also be briefly made to Import Processing Trade which differs from Contract Processing. This is where the China entity that carries on an Import Processing trade is a Foreign Investment Enterprise ("FIE") set up in China. It purchases raw materials from overseas, processes the goods in China and sells finished goods abroad on its own account. It takes ownership title to both the raw materials and finished goods. The buyer of finished goods may be a different person from the one who sold raw materials to the China entity. The Hong Kong enterprise purchases finished goods from the China entity. It may also sell raw materials to the China entity with a mark-up. The purchase and sale contracts between the China entity and the Hong Kong enterprise are ordinary trading contracts;

Under an Import Processing Trade arrangement the China entity is simply a supplier of the goods sold by the Hong Kong enterprise, whether they are related companies or not. The processing activities conducted by the China entity are not operations that give rise to the profits of the Hong Kong enterprise. The Hong Kong enterprise is a trader. It makes trading profits. Where the Hong Kong enterprise carries out its trading activities in Hong Kong, the whole of its profits must be assessed to Hong Kong profits tax;

To avoid the possibility that the typical HK re- invoicing company may come under closer scrutiny by the HK IRD and possibly be drawn into the Hong Kong tax net we would suggest structures that would involve the HK company in a servicing operation and might also involve an offshore trading company. Such structures are beyond the scope of this Newsletter;

Salaries to NZ directors from HK Co. may be an issue. These are subject to HK salaries tax, but tax may be alleviated or avoided with some planning;

Where a structure is set up using HK to capture tax free profits, consideration may be given to obtaining an advance ruling from the HK IRD. An example of such a ruling is attached in Annexure 3. Our firm provides a service in preparing, lodging and prosecuting advance ruling applications. Thorough preparation of applications is necessary.

3. Summary:

It will be obvious from the above comments that taking advantage of HK's tax free environment is more complex than may be first thought and that careful planning along with proper documentation is necessary if profits are not to be assessed by the HK IRD under the current regime;

Our firm operates in both HK and NZ. We offer advice on HK tax structures for trading, manufacturing and licensing of IP in China or China as well as other HK legal services either through our HK office or NZ office.

For more information please contact Tim Brears (tjbrears@transnational.co.nz or PH: 09-4764471).

4. Contacts in Hong Kong:

We have a wide range of business and professional contacts in HK built up over some 25 years. We can recommend nominee directors, accountants, Trust companies and our China agents and professionals.

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ANNEXURE 1

HONG KONG COMPANIES- a summary of legal and other issues for those wishing to set up a company in Hong Kong.

2. **Time to Form HK Company**: Hong Kong Companies can be formed in 24 hours.

3. **Shareholders**: Need one only, who may reside anywhere.

4. **Capital:** no minimum capital- may be as low as HK$2.00- usually formed with say HK$10,000.00 of which say HK$2.00 is issued- $1.00 to each shareholder. Capital can be in any currency;

5. **Directors:** need one only, and he/she can reside anywhere.

6. **Secretary**: Must have a resident secretary in Hong Kong.

7. **Registered office**: Must be in Hong Kong and usually at the office of the Secretary.

8. **Business Registration**: Must be paid to the HK Government annually- currently HK$2,250.00 per annum.

9. **Constitution:** Must have Memorandum and Articles of Association. These are standard, and contain restrictions on the transfer of shares except with Directors consent. Articles of Association may be modified by shareholder agreements.

10. **Costs to form Company**: Around HK$10,000.00 to HK$12,000.00 minimum for standard company but costs are often higher through some corporate service and trustee companies;

11. **Costs to Administer**: Around HK$4,500.00 per annum minimum for provision of registered office by a secretary and to file the annual return at the Companies Registry.

12. **Name Approval**: Can search in 24 hours to check name availability- usually clients buy a shelf company and change the name later.

13. **Audit Costs**: A HK Company must have an accountancy firm to carry out an annual audit and audited accounts must be filed with the IRD. Costs around HK$8000.00 for a simple audit plus once only fee to set up the books- around HK$10,000.00 to HK$15,000.00 if a smaller local firm used. However, if the Company does not trade in HK and has no income in HK, a Nil return may be filed and and a major part of audit costs avoided after 2 or 3 years.

14. **Who Should be Shareholders in a Hong Kong Company**:

    For the company or person establishing a Hong Kong company the choice of shareholder will be dictated by any number of variable factors, including tax in the home jurisdiction, future corporate action, whether a holding or trading company, whether a subsidiary of an offshore holding company in say BVI, whether Hong Kong profits tax is to be avoided and whether nominee director and/or shareholders are required. Accordingly no hard and fast rules can be laid down. However, the following are some general guidelines:

    i. Nominees: Where there is a desire for anonymity a corporate Director and Shareholder may be appointed. In addition, where the role of the company is non- trading and passive and there is a desire to avoid signing of shareholder/director resolutions and excessive paperwork, nominees may be more practical, although costs will be higher;

    ii. Trading: May be appropriate to have offshore Director ex Hong Kong so as to counter a suggestion by the HK IRD that the operations of the Company are in Hong Kong. However, tax issues are involved as a company managed and controlled by its directors may be tax resident ion the country where the directors are resident.

    iii. Investment: May be appropriate to be owned by an offshore family trust or local trust. Hong Kong imposes no tax on profits accrued in a trust or on trust distributions;

    iv. Holding Company: May be owned by overseas parent but will depend on other factors, such as tax and possible future corporate activity;

    v. Offshore Holding Company: Where potential new shareholders, possible sale of operations, future funding of subsidiaries or trading operations to avoid HK profits

tax, may be useful for offshore BVI as a holding company to own the HK company which in turn owns trading assets or subsidiaries. HK tax and stamp duty may be avoided. Generally easier to restructure or issue new shares in an offshore company;

vi. Joint Venture Company: Will depend on tax issues in home jurisdiction if a foreign party, but parent company may prefer to limit the possibility of direct claims by the joint venture partner by holding shares through an offshore BVI company with no audit, accounting and dividend distribution requirements, or possibly through another Hong Kong company.

15. **General**:

i. The Hong Companies Ordinance allows corporate directors and shareholders (confidentiality reasons), appointment of nominees as directors.

ii. The HK Company Ordinance does not have strict solvency rules and directors are rarely to be held personally liable in a liquidation unless there is clear evidence of fraudulent trading.

TAX

1. **Nature of Taxes**: For a Company there is only profits tax at the flat rate of 16.5%.

2. **No other Taxes**: There is no GST, Fringe Benefit Tax, dividend taxes, interest taxes, deemed dividends or capital gains. There are no withholding taxes on transfer of dividends or interest out of a HK company to shareholders overseas.

3. **Salaries Tax:** There is salaries tax on Directors salaries paid in Hong Kong at a flat rate of 15%.Planning to avoid some salaries tax is available for overseas directors who may limit time spent in Hong Kong.

4. **Stamp Duty**: There is stamp duty at 0.2% on a transfer of shares.

5. **General Scheme of Taxation in Hong Kong**:

Hong Kong is a low tax jurisdiction (15% and 16.5% for individuals and companies respectively), and operates a territorial tax system which exempts tax on profits earnt outside Kong Kong's borders. Profits tax is assessed on companies, partnerships and other business entities, and, in very limited circumstances, a trustee, in respect of income earnt in Hong Kong.

Tax efficient structures are possible to capture profits tax free in HK and we can advise over the best method taking into account the trading business of the HK company and the tax residency of its shareholders.

5.1 **Gifts**

There is no gift duty in Hong Kong, and gifts of property in Hong Kong, or the forgiveness of a debt based in Hong Kong or elsewhere, attracts no gift duty nor are there any profits or other tax consequences based on accrual accounting rules, which do not exist in Hong Kong.

5.2 **No Capital Gains or Goods and Services Taxes**: Hong Kong has no capital gains taxes and no Goods and Services or Value Added Taxes.

5.3 **Hong Kong Estate Duty**: Has been abolished.

5.4 **Withholding Taxes**: There are no withholding tax on interest or dividends remitted from Hong Kong.

5.5 **Tax Treaty With China**: Hong Kong has just concluded a tax treaty with China allowing giving substantial advantages to a HK company investing in China, which allows very low withholding taxes on interest, royalties and other payments remitted from China to the HK company.

6. Summary of the Advantages of using a Hong Kong Company

Much will depend on the personal circumstances and country of residence of the shareholders but Hong Kong would appear to offer the following advantages over other well known tax havens:

1. **Stable political Environment**: China has lived up to its promises to implement the 'one country , two systems' enshrined in the Joint Declaration between Britain and China, and other than defense and foreign policy, is not involved in policy issues in Hong Kong. Moreover, China has signed inter- government agreements protecting the interests and property of foreign countries and individuals in Hong Kong ("Investment Promotion and Protection Agreements"). Hong Kong itself has a bill of rights and is a signatory to most major international conventions on human rights.

2. **Major Financial Centre**: A company established in Hong Kong enjoys major advantages over companies in other tax havens because of access to major international banks and investment opportunities. As well, banking, legal and accounting services of the highest caliber are available in Hong Kong as opposed to offshore tax havens where such services in combination with sophisticated banking and management services are rarely available in one location.

3. **No Exchange Controls and Peg with US. Dollar:** Hong Kong has no currency controls and the local Hong Kong Dollar is pegged to the US unit at HK$7.80/1USD. Funds in any currency from 50 of the world's largest banks can be freely transmitted at any time.

4. **Bank Accounts:** Unlike other tax havens, bank accounts in most currencies at major banks such as Citibank, Bank of America, HSBC etc. can be opened in Hong Kong in a few days.

5. **No Tax on Interest and Dividends and no withholding Taxes:** A major advantage for a company which has large deposits in a bank in Hong Kong or local share market investments is that there is no tax on interest, no tax on dividends, and both interest, dividend income or other profits derived by the trust can be remitted offshore without any withholding or other taxes. In other tax havens, such income or profits derived locally may be taxed.

6. **No Residency/ Approval for Foreign Settlors:** Hong Kong has no controls on foreign persons or entities establishing companies or settling trusts or buying assets in Hong Kong.

7. **Asset Protection:** Hong Kong law follows the law of the United Kingdom and other commonwealth countries and protects assets transferred to a company or Trust so long as the settlor at the time is solvent and is not engaged in a fraudulent attempt to avoid creditors.

8. **Reciprocal Enforcement of Foreign Judgments:** Hong Kong has legislation allowing enforcement of foreign judgments and foreign settlors can therefore be assured they have rights to take action outside Hong Kong, as well as in the Territory, to enforce a judgment affecting a Hong Kong Trust.

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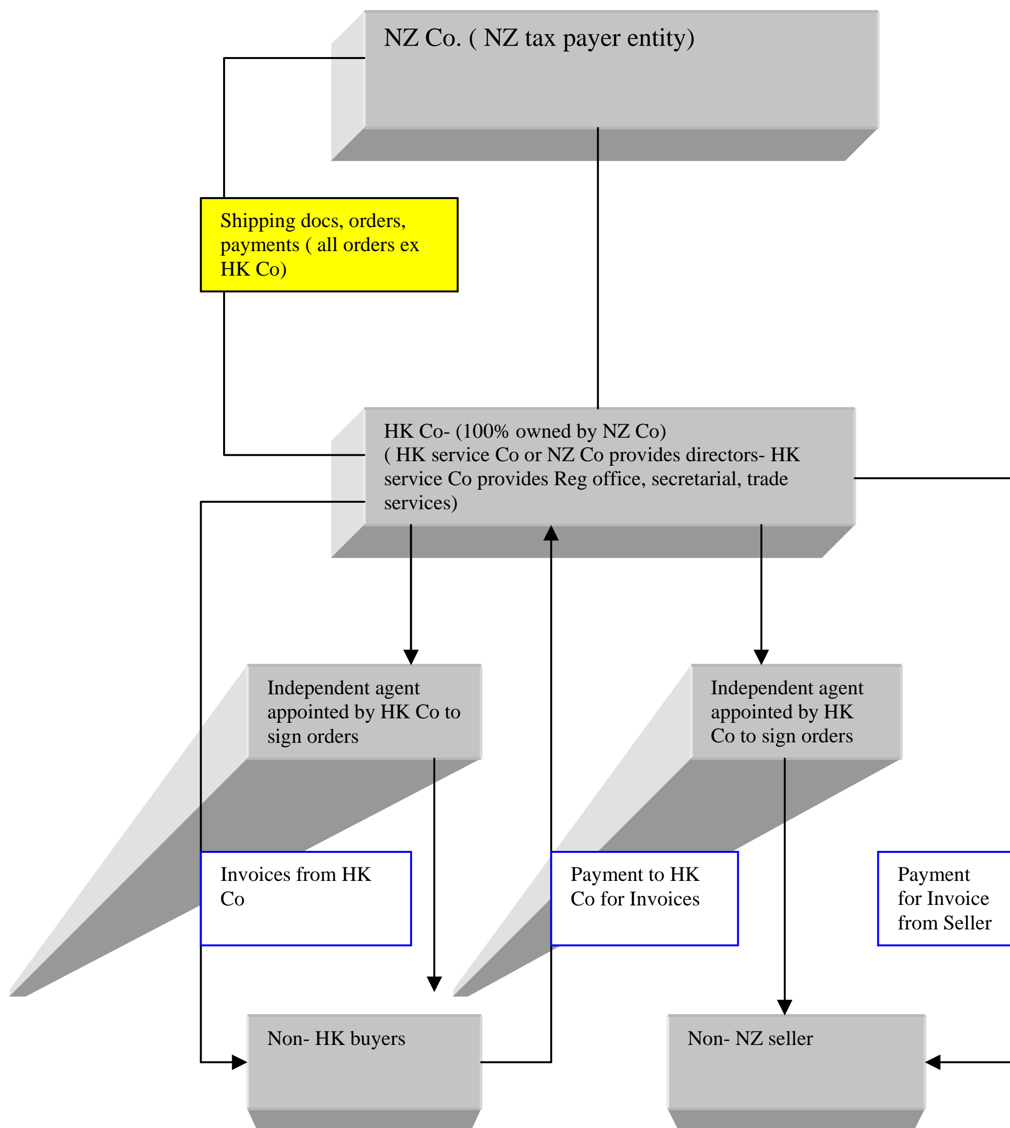
ANNEXURE 2



Notes:

1. Above structure an example only- final structure needs to be more detailed and based on the a thorough examination of the intended trading method to see what is practical and likely to pass scrutiny of the HK IRD;
2. If PRC processing or manufacturing involved other structures would need to be considered;
3. In some cases, offshore purchasing company in BVI may be appropriate.
4. Operations of HK Co must be restricted to issuing invoices and collecting/paying funds;
5. If the proposed operation is substantial, advance ruling from the HK IRD may be advisable.

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ANNEXURE 3

Advance Ruling Cases

Rulings are published for general reference only. Caution should be exercised in relying upon the rulings. Reference can only be made to a ruling if the facts are identical to the proposed transactions. To that end it should be borne in mind that similar transactions often have different facts. If there are any doubts as to the similarity of the proposed transactions the taxpayer should request a ruling. Caution should also be exercised to ensure that the relevant provisions of the Ordinance or the relevant case law interpretation and practice of those provisions have not changed as the Inland Revenue Department is bound to apply the current taxation law. Similarly, a ruling may no longer be appropriate if an administrative practice outlined therein turns out to be used as a tax avoidance device.

In order to protect taxpayer confidentiality, the Department will edit the selected rulings prior to publication. Accordingly, all information that may enable identification of the taxpayer will be removed from the edited version.

The Department will not update the rulings published on the website to reflect any subsequent changes of the tax law.

The provisions of the Ordinance

This ruling applies in respect of section 14 of the IRO.

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2. Background

(a) The Company was incorporated in Hong Kong on 31 March 1999. Its business is the trading of accessories.

(b) It maintains a registered office in Hong Kong through a local accounting firm (the Hong Kong Office).

(c) The beneficial owner of the Company is Mr A who is the sales manager of Company B, which is a company incorporated in Australia and is a major supplier of the Company.

(d) Mr A is responsible for negotiation and conclusion of sales and purchase contracts, for both Hong Kong and overseas sales. He ordinarily lives in Australia and visits Hong Kong at intervals of about three months.

(e) The local accounting firm will perform documentation and other administrative works, such as preparing purchase and sales orders, invoices, operating bank accounts and maintaining accounting records, under instructions from Mr A.

(f) The goods are mainly sourced from overseas suppliers. The local accounting firm places the purchase orders to the suppliers and accepts sales orders from customers in Hong Kong under Mr A's instructions. The suppliers then send the invoices, packing lists and other documents to the Hong Kong Office.

(g) The suppliers deliver the goods to the Company for sales to local and other overseas customers and the goods are kept in warehouses in Hong Kong.

(h) The Company pays the suppliers by L/C and T/T and receives settlement from customers by L/C.

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3. The arrangement

(a) A PRC agent is appointed by Company B to act as its agent for the sales of accessories to a customer in PRC.

(b) Mr A negotiates with the PRC customer and the said PRC agent directly for price, quantity, quality and shipment of the sales and at the same time negotiates with the supplier in Italy for price, quantity, production schedule and delivering of the goods.

(c) Upon confirmation of sales, Mr A will ask the PRC customer to issue purchase orders to the Hong Kong Office directly and at the same time inform the local accounting firm of the details of the transactions. Then the local accounting firm will place purchase orders to the Italian supplier in accordance with Mr A 's instructions. The goods are shipped to the PRC customer directly.

(d) The settlement from the customer and to the supplier are by L/C on a back-to-back basis arranged by the local accounting firm.

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4. The ruling

The profits arising from sales made to the PRC customer are onshore profits subject to Hong Kong Profits Tax.