

Investment opportunities in Asia Pacific via the Hong Kong platform

Siegfried Verstappen,
Invest Hong Kong
Brussels office

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Practical tips for doing business with China

VOKA Hasselt seminar



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What does the global crisis mean?

In China they use this symbol to denote crisis:

危机



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What does the current crisis mean?

危机 or Crisis

Is composed of:

危

Which means “danger”

AND

机

Which means “opportunity”



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What does the current crisis mean?

CRISES

=

OPPORTUNITIES



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What Hong Kong offers to mainland China

- Gateway to global markets (Mainland's "Going Out" policy)
- 69 of world's top 100 banks have operations in Hong Kong
- international retail centre. Ideal launch-pad for new products and expansion overseas
- Excellent investment environment for Mainland enterprises to become familiar with international corporate practices and markets
- Regulatory framework follows international standards to provide fair, transparent and efficient financial marketplace
- Professional and government bodies ensure international standards; corporate governance rigorously enforced
- Arbitration awards made in Hong Kong and the Mainland are reciprocally enforceable
- Fund raising and Renminbi (RMB) clearing centre



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RIGHT PLACE

Hong Kong's Enduring Advantages

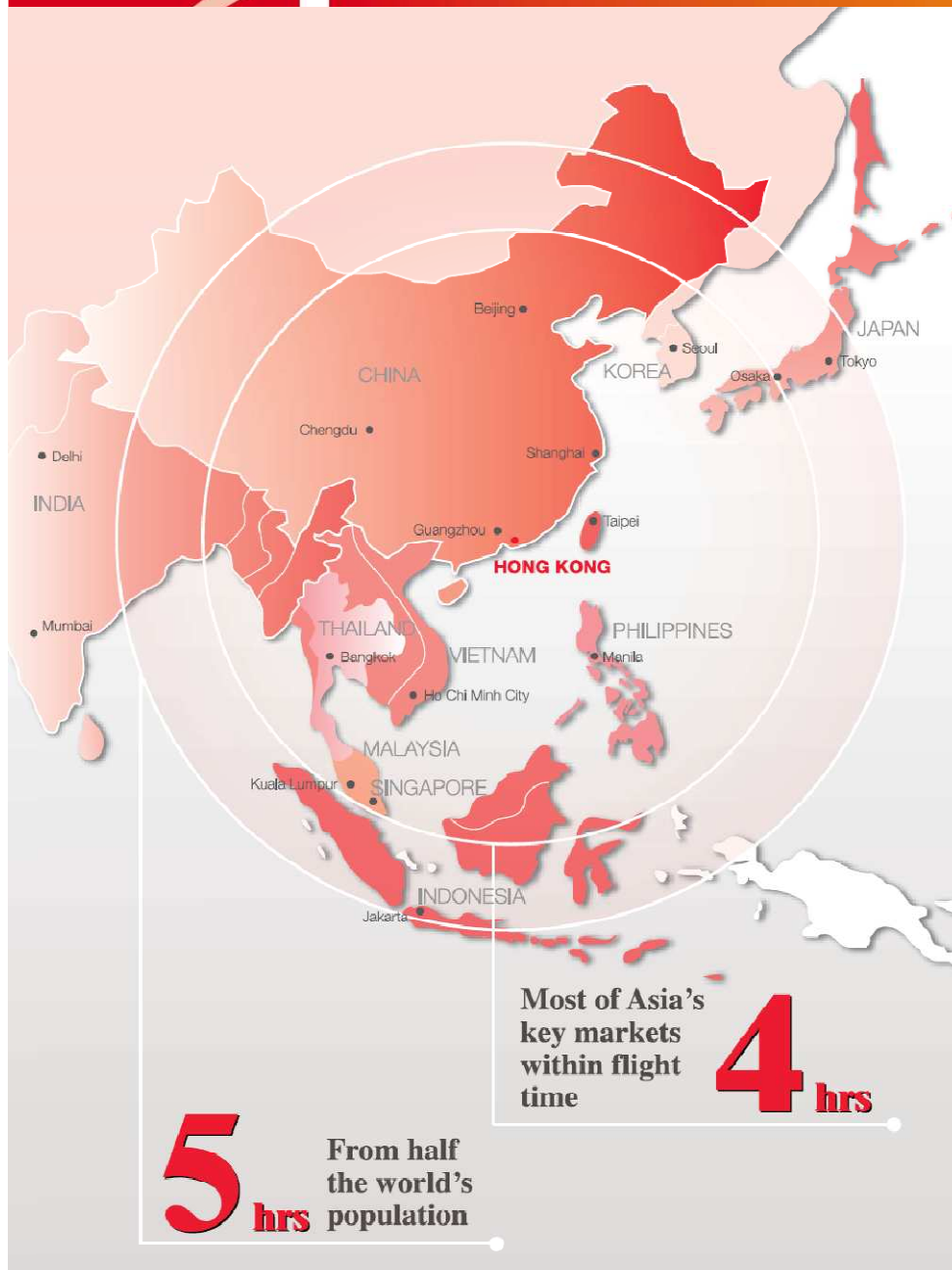


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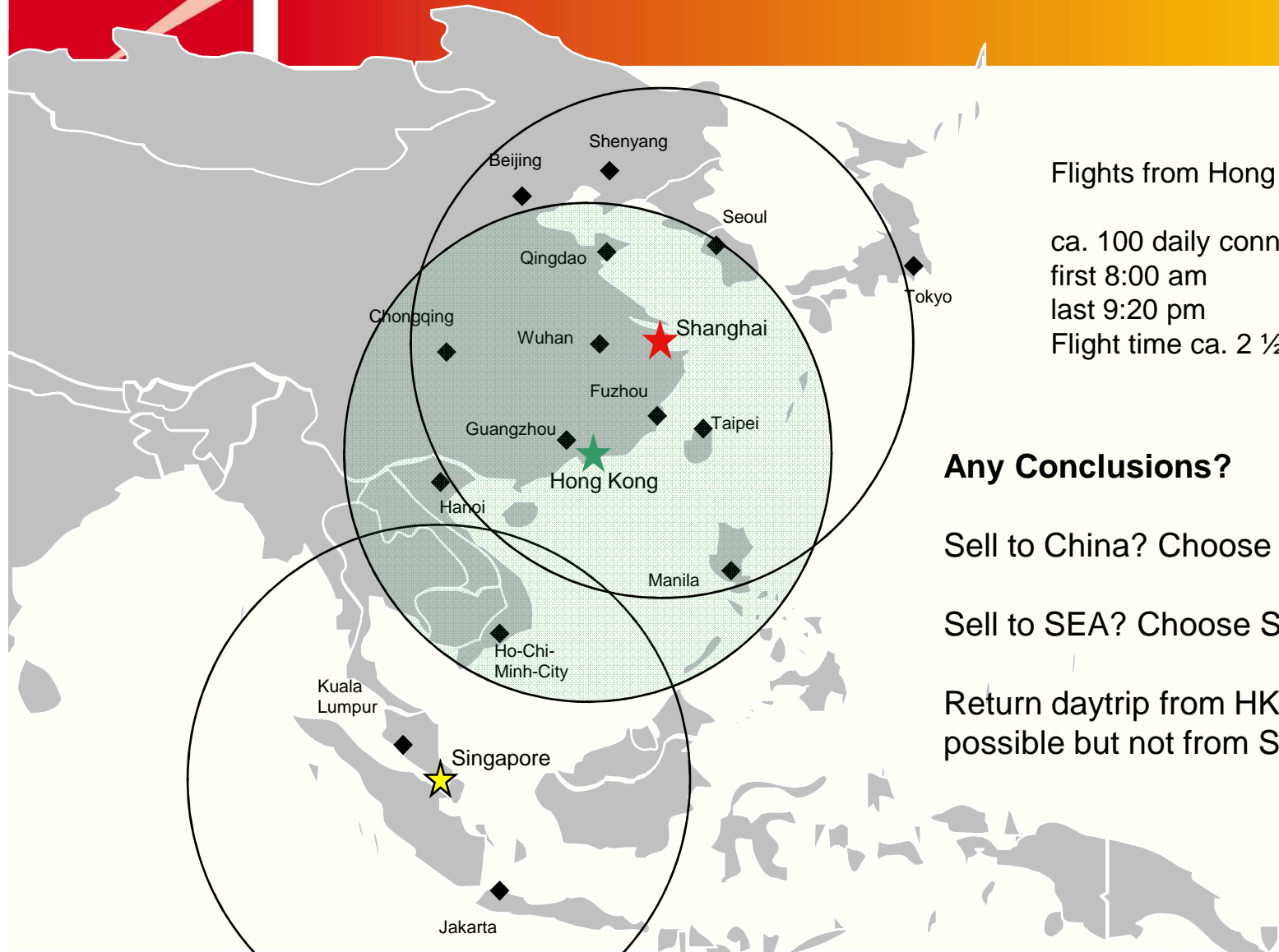
Heart of Asia



- The world's 4th busiest international passenger airport
- Around 90 scheduled airlines operating some 750 flights per day to about 150 destinations
- One of the world's busiest container ports
- 23 minutes from central business districts to Airport by high-speed train

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Hong Kong and its reach within Asia



Flights from Hong Kong to Shanghai

ca. 100 daily connections
first 8:00 am
last 9:20 pm
Flight time ca. 2 ½ h

Any Conclusions?

Sell to China? Choose HK or SHA

Sell to SEA? Choose Singapore

Return daytrip from HK to SHA is possible but not from Singapore



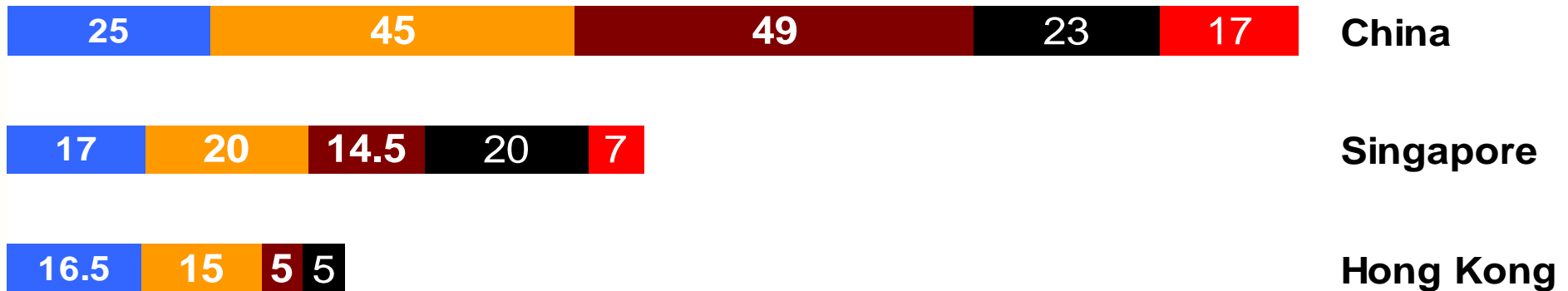
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The circle represents approx.
3 h of flight or 1800 km

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Low and Simple Tax System

■ Corporate Income ■ Personal Income ■ Employer Social Security ■ Employee Social Security ■ VAT



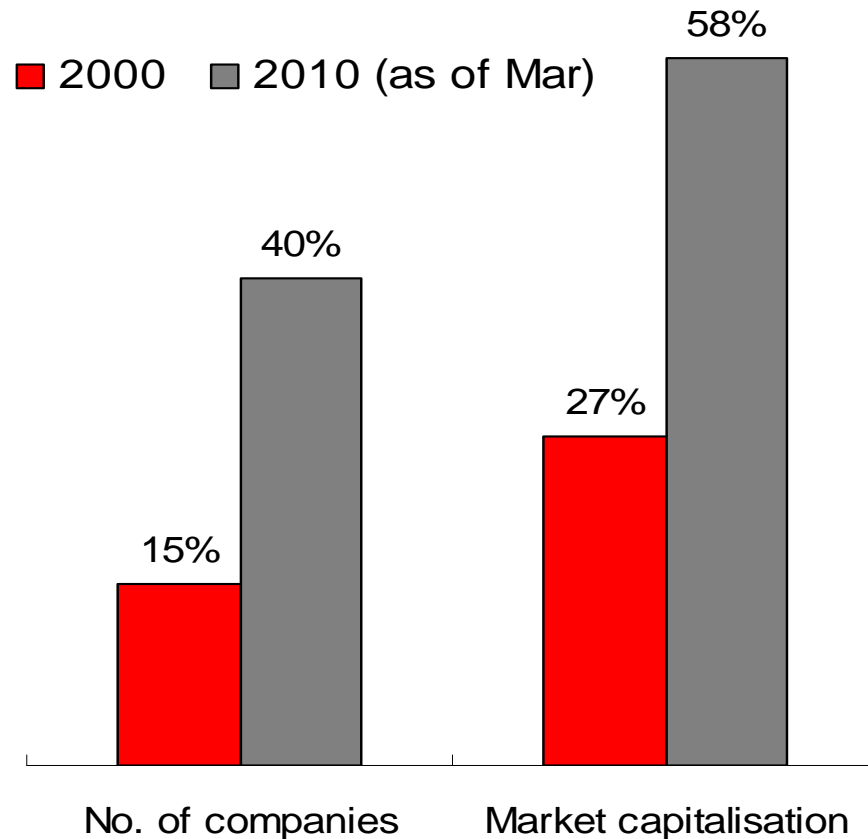
Only imposes 3 direct taxes: profits, salaries, property

- **NO** VAT/GST or sales tax
- **NO** Estate duty
- **NO** Capital gains tax
- **NO** Global taxation (offshore income and only HK-sourced income is taxable)
- **NO** Withholding tax on dividends and interest
- **NO** Wine duty

WORLD RANK	COUNTRY	FREEDOM SCORE	CHANGE FROM PREVIOUS								
1	Hong Kong	89.7	-0.3	62	Portugal	64.4	-0.5	123	Côte d'Ivoire	54.1	-0.9
2	Singapore	86.1	-1.0	63	Romania	64.2	+1.0	124	India	53.8	-0.6
3	Australia	82.6	0.0	64	France	64.2	+0.9	125	Moldova	53.7	-1.2
4	New Zealand	82.1	+0.1	65	Saudi Arabia	64.1	-0.2	126	Papua New Guinea	53.5	-1.3
5	Ireland	81.3	-0.9	66	Thailand	64.1	+1.1	127	Tonga	53.4	-0.7
6	Switzerland	81.1	+1.7	67	Turkey	63.8	+2.2	128	Tajikistan	53.0	-1.6
7	Canada	80.4	-0.1	68	Montenegro	63.6	+5.4	129	Niger	52.9	-0.9
8	United States	78.0	-2.7	69	Madagascar	63.2	+1.0	130	Nepal	52.7	-0.5
9	Denmark	77.9	-1.7	70	Dominica	63.2	+0.6	131	Suriname	52.5	-1.6
10	Chile	77.2	-1.1	71	Poland	63.2	+2.9	132	Cameroon	52.3	-0.7
11	United Kingdom	76.5	-2.5	72	South Africa	62.8	-1.0	133	Mauritania	52.0	-1.9
12	Mauritius	76.3	+2.0	73	Greece	62.7	+1.9	134	Guinea	51.8	+0.8
13	Bahrain	76.3	+1.5	74	Italy	62.7	+1.3	135	Argentina	51.2	-1.1
14	Luxembourg	75.4	+0.2	75	Bulgaria	62.3	-2.3	136	Ethiopia	51.2	-1.8
15	The Netherlands	75.0	-2.0	76	Uganda	62.2	-1.3	137	Bangladesh	51.1	+3.6
16	Estonia	74.7	-1.7	77	Namibia	62.2	-0.2	138	Laos	51.1	+0.7
17	Finland	73.8	-0.7	78	Cape Verde	61.8	+0.5	139	Djibouti	51.0	-0.3
18	Iceland	73.7	-2.2	79	Belize	61.5	-1.5	140	China	51.0	-2.2
19	Japan	72.9	+0.1	80	Kyrgyz Republic	61.3	-0.5	141	Haiti	50.8	+0.3

Mainland Companies in Hong Kong

% of Mainland companies listed in HK and their market capitalisation



- As at end 2009, 4,792 Mainland companies have MOFCOM approval to establish subsidiaries in HK with a total investment of US\$29.3 bn
- 934 new investment projects approved in 2009, with an investment amount of US\$8.5 bn (MOFCOM)
- RMB deposits in HK increased to RMB 64 billion as of January 2010

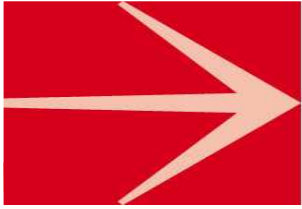
Source: HKEx



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China's Risk Manager

No other city in the world can help overseas investors manage the risks inherent in entering Mainland markets as well as Hong Kong. This is an important part of the reason why overseas firms prefer Hong Kong for the highest-value activities that they perform in the Asia-Pacific region.”

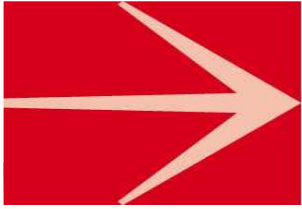
Michael Enright, Sun Hung Kai Properties Professor,
School of Business, University of Hong Kong



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Foreign entrepreneur's perspective

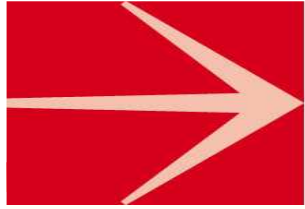
What is the most crucial element in the decision making process regarding an investment abroad for an entrepreneur?



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Foreign entrepreneur's perspective

CONFIDENCE!



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The foreign entrepreneur's perspective

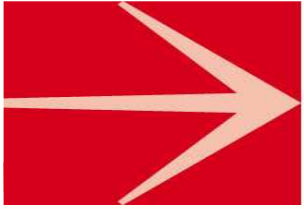
CONFIDENCE that
he will achieve the
greatest added value
by choosing a
particular route



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Hong Kong's Elements of Strategic Confidence

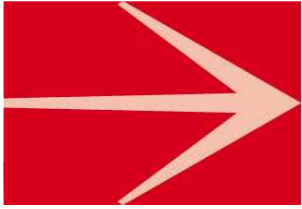
- Intellectual property rights
- Legal recourse
- Access to the Chinese market (CEPA)
- Hong Kong's currency advantage
- Credit risk insurance
- Market research
- Taxes



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IP rights in China: problem

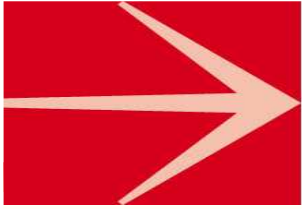
- China has signed the WTO treaty and is committed to protecting IPR. In practice, this will take many years before it is fully implemented. Meanwhile, only a few thousands of well-known international foreign brand names enjoy automatic protection
- EVERYONE ELSE needs to register his brand name, trademark, patents, etc if you want to be able to have legal recourse inside mainland China against copyright infringement
- Example: many firms find out that their brand name or trade mark has already been registered in mainland China by local entrepreneurs and are forced to buy back their rights



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IP rights in China: solution

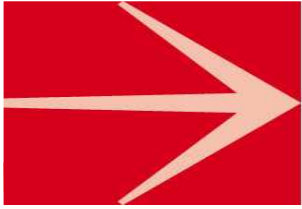
- Foreign high tech, engineering and design firms can become a part of the Hong Kong Science & Technology Parks network
- HKSTP has pre-arranged networks with both the Shenzhen Science Park and a network of universities around Xian, ensuring that sensitive design can be done with full protection in HK, while test runs, pilot plants and qualified labour are provided through the partners in mainland China
- Website: www.hkstp.org



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Legal recourse: problem

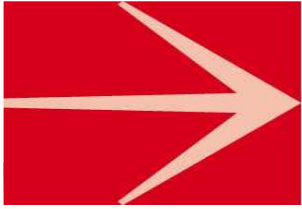
- Mainland China has no tradition of Western style law and jurisprudence
- Many lower courts are not yet fully conversant with new laws regulating commercial, investment or IPR issues
- Non-Chinese firms (and most Chinese firms) find it very difficult and time-consuming to obtain their rights through the Chinese courts



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Solution A: HK International Arbitration Centre

- Agree with the mainland Chinese partner that any disputes regarding the execution of the contract will be submitted to the Hong Kong International Arbitration Centre.
- Both Hong Kong and mainland China have signed the Convention of New York : any arbitration award from HK is immediately executable in China*
- HK based law cabinets confirm that the system is working speedily, smoothly and satisfactorily
- Website: www.hkiac.org

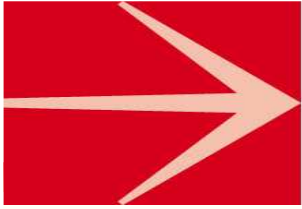
*(enforceable between HK and mainland China since February 2000)



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Sol. B: Sue in HK, enforce in China

- A new agreement on July 16, 2006, between HK and mainland China : if parties had provided for this in their contract, verdicts from the Hong Kong courts are immediately executable in mainland China*
- It covers *money judgments and commercial cases*
- The contract has to stipulate expressly in writing that the HK court has exclusive jurisdiction
- Applicable whenever the judgment debtor keeps his assets in mainland China

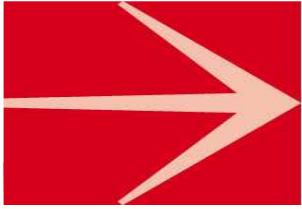
*(enforceable between HK and mainland China since August 2008)



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Access Chinese markets: problem

- Many foreign investors find that, although China has joined the WTO, its markets remain closed or protected against foreign competition
- This applies both to trade in goods and trade in services



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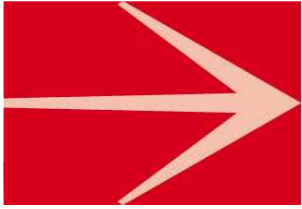
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Solution: Closer Economic Partnership Arrangement (CEPA)

- Since July 2003, Hong Kong and mainland China have signed a type of free trade agreement, providing preferential access into mainland China for HK based goods and service providers (CEPA)
- Overseas companies can take advantage of CEPA by outsourcing to, partnering with a CEPA qualified manufacturer or service provider, or having their goods qualified as HK origin.
- CEPA being rolled out in phases : current scope and benefits of CEPA likely to expand – CEPA VII now applicable. Listing of applicable CCN can be found at:
http://www.tid.gov.hk/english/cepa/tradegoods/files/mainland_2010.pdf





Hong Kong's currency advantage

- The HK\$ is pegged to the US\$ and is fully and automatically convertible against other currencies.
- The RMB is not a convertible currency except in HK – many sourcing companies use this to their advantage when settling payment with Mainland Chinese suppliers.
- With support from the Hong Kong and Mainland Chinese Authorities, a RMB cross border currency settlement scheme is operational since May 2009.
- The list of eligible mainland firms is now enlarged to include firms approved by the PBOC and which have a “sound” customs record in terms of the mainland China Customs rating system

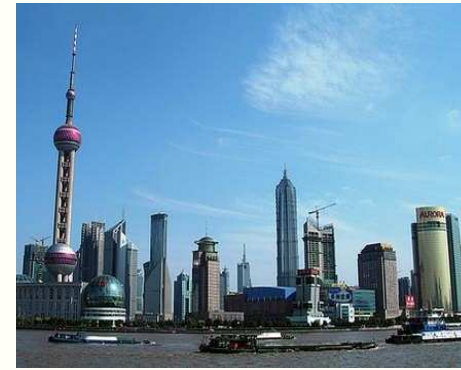
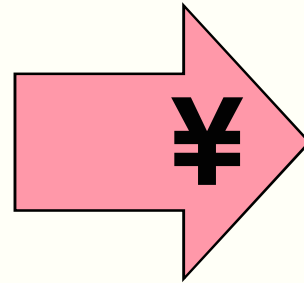


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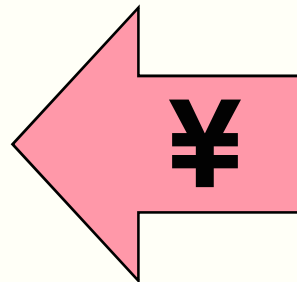
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What is the RMB Trade Settlement Scheme?

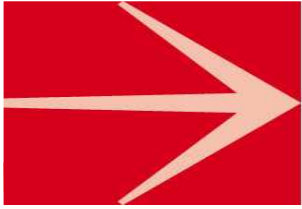


Trade of Goods
Trade of
Services



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US\$ 1 to RMB in since 2005



Reasons to start the RMB Trade Settlement scheme

- Tackle the mismatch / under representation of RMB in international trade
- Global financial turmoil has created greater volatility in foreign exchange markets

InvestHK Reduce exchange rate risks and transaction costs in cross border trade



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China uses VAT refunds as an incentive / disincentive for exports

China exports severely hit repeatedly by Chinese government's actions

MOFCOM (Ministry of Commerce of the People's Republic of China) cut VAT refund for 2,831 commodities, as at July, 1st 2007.

2007

- More than a third of the total number of items listed on customs tax regulations.
- Items list includes shoes, clothing and plastic goods.
- Policy announced just 10 days before going into effect to avoid any export boom.
- Chinese companies affected by VAT rebates cuts rushing exports until July 1st.

The government raised the VAT rebate on textiles from 11% to 13%.

2008

Caishui [2010] No.57 - Revoke the export VAT refund for 406 items

2010

Effective 15 July, 2010

More Changes are expected over the next 12 – 18 months...



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Background to the RMB Trade Settlement Scheme

Pilot Cities (initially)

- 5 pilot cities (Shanghai, Guangzhou, Dongguan, Zhuhai and Shenzhen)

Eligible transactions:

- Cross border trade
- Service trade

Eligible Enterprises in Mainland China:

- 365 Mainland Designated Enterprises (initially)
- Transactions with non-MDEs now allowed after PBOC registration

Coverage:

- Hong Kong / Macau / ASEAN member countries
- Countries beyond ASEAN allowed (highly dependent on access)



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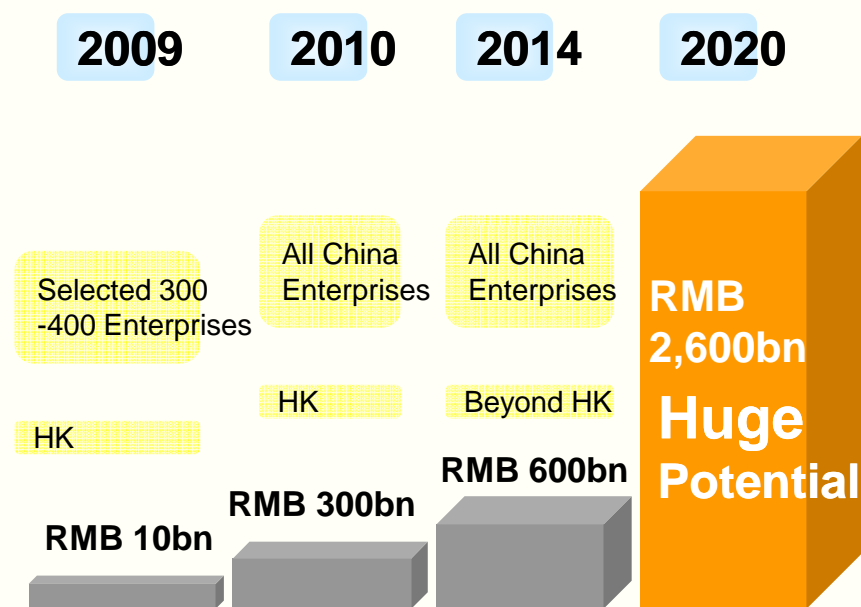
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How to make use of new RMB possibilities in Hong Kong?

- Shift of currency exchange risk out of China and into Hong Kong
- Mature hedging possibilities in Hong Kong
- One risk less → smaller transaction cost
- Better purchasing prices → depending on supplier structure and background and negotiation
- Liquidity management from outside China
- Keep RMB offshore – Revaluation ahead?
- Experienced trade financing available in Hong Kong

Estimated RMB trade flow in HK



Source: Strategy and Economics Asia Pacific, HSBC



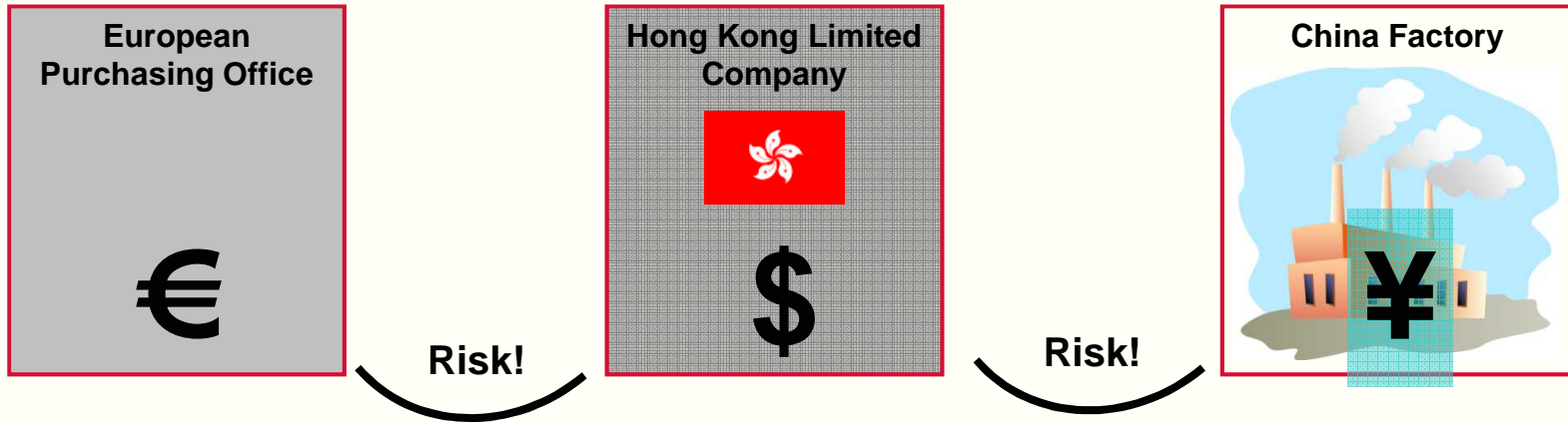
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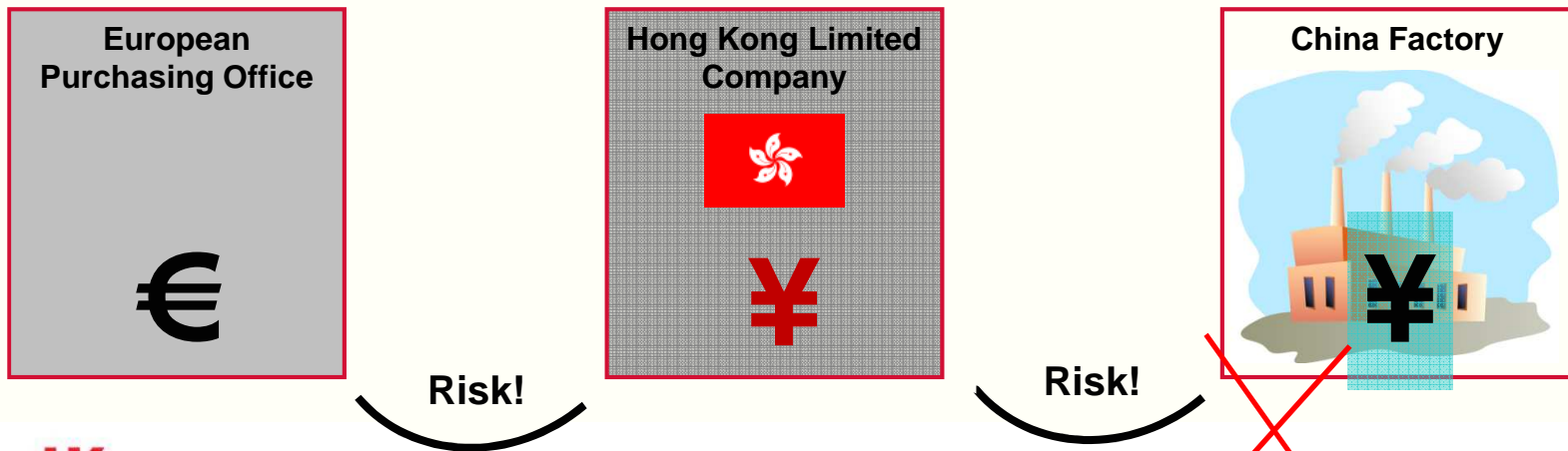
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How to make use of new RMB possibilities in Hong Kong?

PREVIOUSLY



Using RMB Scheme



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Why use the RMB trade settlement Scheme via Hong Kong and not other places?

- HKMA's taking a role early on
- Most experience gathered in HK through participation since signing of MOU / Launch June/July 2009
- Cutting edge location for China purchasing and sales
- Mature financial institutions in Hong Kong
- Comprehensive investment possibilities in China and rest of Asia
- PBOC has given HK branch task of clearing all RMB settlements in ASEAN countries as well



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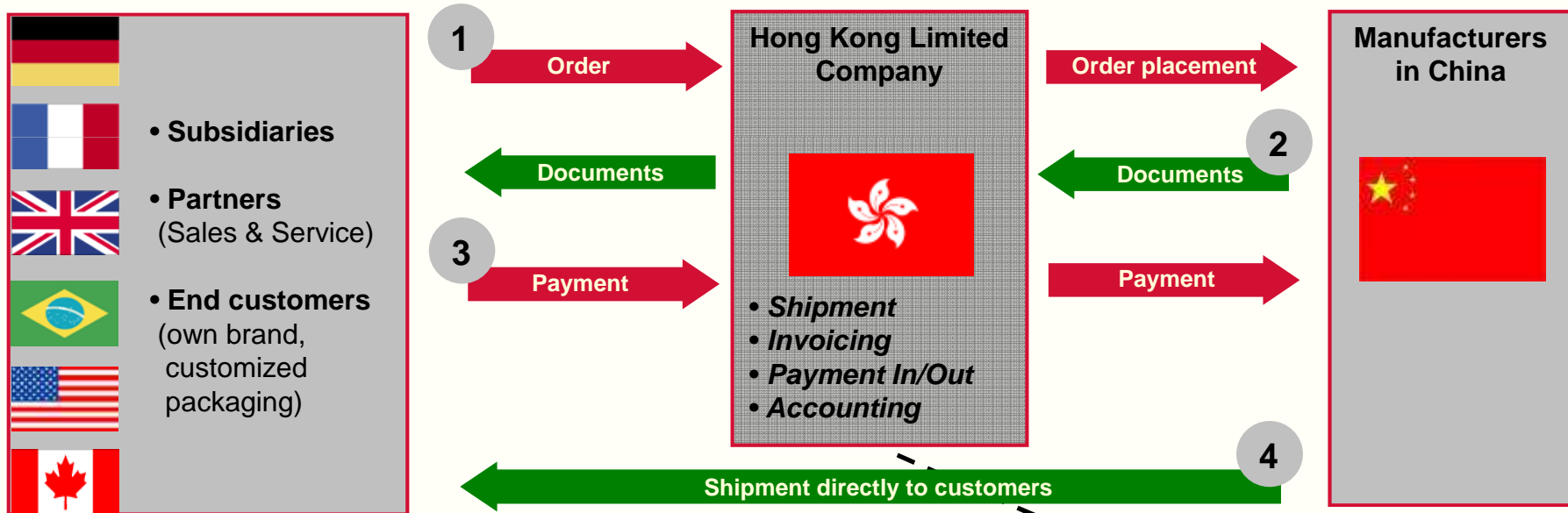
OUTSOURCING MANUFACTURING TO CHINA

Exporting through a Hong Kong Trading Company helps to optimize China sourcing

Benefits of using this structure

Customer does not know the manufacturer

1. Direct sales to subsidiaries, partners and end customers in other countries
2. Profits are “locked” in Hong Kong and not in China



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WHY HONG KONG? – WHY NOT SHANGHAI?

- Direct sales and direct invoicing from Hong Kong to overseas' subsidiaries and to customers
- FOB shipment to the customer, **No direct contact between customer and manufacturer**
- **Profits are “locked“ in Hong Kong and not in China: taxed in Hong Kong and not in China!**
- Goods do not touch the intermediary's warehouse
- **No VAT refund complications**
- **Reduced cost and risks:**
 - Transport and shipment cost
 - Finance cost
 - Credit risk
- **Customer benefits from lower price**
- Reliable legislation, easy taxation, low corruption



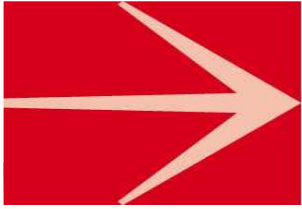
The ideal combination:

The Hong Kong Limited Company executes the trade transactions and the Representative Office / WFOE in China manages quality control and/or manufacturing.



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Hong Kong's credit risk insurance advantage

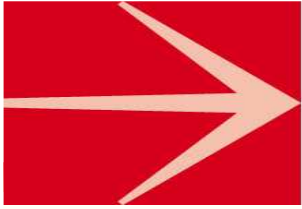
- Hong Kong based firms exporting goods to other markets can obtain both country risk and buyer risk insurance from a HKSAR agency called:
- Hong Kong Export Credit Insurance Corporation (ECIC)
- Website: <http://www.hkecic.com/eclink/infoCenter.jsp>
- Insurance premium can be as low as 0.39%



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Hong Kong's market research advantage

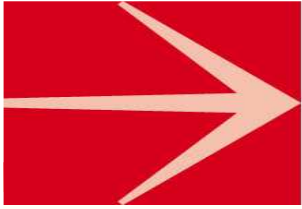
- Hong Kong based firms can access the database managed by the Hong Kong Trade Development Council
- The TDC manages an online sourcing platform that connects over 120,000 credible suppliers
- over 800,000 worldwide buyers use the platform to source products and services provided by China, Hong Kong, and Asian suppliers
- Website: www.tdctrade.org



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Chinese taxes: problem

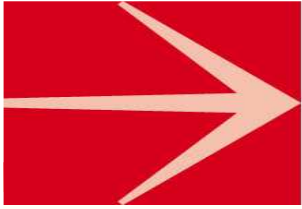
- Foreign investors could benefit from tax holidays when they made an investment (in the SEZ or university parks)
- But there is a bewildering array of sales and consumption taxes and the local authorities can impose new taxes due to a fast changing legislation.
- Moreover, China has harmonized its tax systems since January 2008. The corporate tax rate in future will be 20% (SME's, particular categories) to 25%



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Chinese taxes: solutions

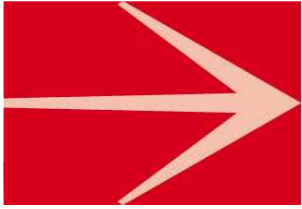
- Objective: reduce your taxable income in mainland China
- The Double-taxation avoidance treaty between HK and mainland China allows, to a certain degree, the imputation of expenses by HK parent companies to mainland affiliates
- Examples that could qualify under certain conditions: market research, personnel support or recruitment, quality control inspectors, logistics coordination, etc....
- Hong Kong corporate tax rate is 16.5% and even 0% for offshore incomes
- Hong Kong companies can deduct 50% of their income from joint ventures with mainland Chinese firms from taxable revenue



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Chinese taxes: solutions

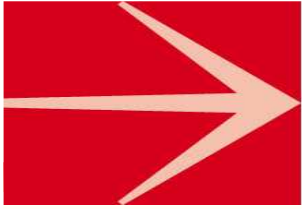
- The Double-taxation avoidance treaty (DTAT) between HK and mainland China brings in new rates for transfer of dividends, interest, and royalty payments from mainland China firms to their HK parent companies
- In practice, withholding taxes are now greatly reduced on these forms of transactions:
 - 5% for dividend payments
 - 7% for interest payments
 - 7% for royalty payments



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Chinese taxes: solutions

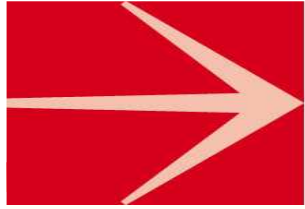
- The DTAT between Hong Kong and Belgium provides a unique pathway to repatriate profits derived from doing business with mainland China with a minimum of additional taxes.
- Withholding taxes in Belgium are greatly reduced if you meet the conditions required by the treaty:
 - 0% for dividends and interest payments, 5% for royalties
- Within Belgium, the only remaining taxes are then regulated by the DTI statutes (95% exemption)
- Moreover, Hong Kong signed a DTAT treaty with Luxembourg on November 2 2007, now in force:
 - No withholding taxes in Luxembourg plus 100% DTI regime
- Finally, Hong Kong has signed in 2010 other DTAT treaties following the OECD model with the Netherlands, Austria, Hungary, Ireland, the UK, France and Liechtenstein



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Invest Hong Kong: how we can help

Enjoy our free of charge services

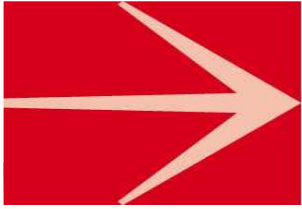
- Latest **information** on business environment and opportunities
- **Contacts** for all aspects of business establishment
- Arranging tailored **visit programmes**
- **Support and assistance** with visa applications, trade regulations etc.
- **Public relations** services during your launch/expansion
- **Advice** on settling in Hong Kong – housing, schooling, healthcare



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- Rue d'Arlon/Aarlenstraat 118, B-1040 Brussels, Belgium
- Telephone +32/2/775 00 76
- E-mail: siegfried_verstappen@hongkong-eu.org
- Websites: www.investhk.gov.hk and: www.hongkong-eu.org
- Hong Kong background information:
- <http://www.brandhk.gov.hk/en/#/en/facts/factsheets/index.html>



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