

## China Tax/Business News Flash

### CEPA– A New Era for Hong Kong Companies

The governments of the People's Republic of China and the Hong Kong Special Administrative Region signed the Closer Economic Partnership Arrangement (CEPA) on 29 June 2003 in Hong Kong. After an eighteen-month discussion, CEPA has come up with measures expected to strengthen trade and investment co-operation between the Mainland and Hong Kong, and to promote further economic links between the two sides. CEPA is also viewed as a strong support to boost Hong Kong's economy, facilitating Hong Kong companies' trade and investment in China by way of lifting customs tariffs, liberalizing market access and lowering investment thresholds.

We summarize below the key provisions of CEPA.

CEPA covers three broad areas, namely the sale of goods, the provision of services, as well as trade and investment facilitation crossing the border.

#### On the sales of goods

The Mainland has agreed to apply zero import tariffs from 1 January 2004 for exports with Hong Kong as the Country of Origin for 273 categories of products. The Mainland has also agreed to apply zero import tariffs by 1 January 2006, the latest, upon applications by local manufacturers for other codes maintained on the China's tariff system and meeting the CEPA Country of Origin rules. However, further details on interpretation and implementation of the Country of Origin have yet to be provided.

Hong Kong will undertake to continue applying zero tariff rates on all goods of Mainland origin and not to impose restrictive regulations on trade in these goods.

The following products will be exempt from China import duty from 1 January 2004 provided that they meet the CEPA rules of origin requirement:

- **Electrical and Electronic Products** such as motors, generators, transformers, converters, certain batteries, certain mechanical tools and appliances and their parts, certain parts for audio-visual appliances etc.
- **Plastic Articles** such as certain polystyrene and polyvinyl chloride in primary forms, certain plastic materials and scraps etc.
- **Paper Articles** such as specified papers, paperboards and corrugated papers, specified printed matters etc.
- **Textiles and Clothing** such as certain yarns and fabrics, parts of garments, shirt, blouses, pullovers etc.
- **Chemical Products** such as lubricating oil, certain pigments, dyes, paints etc.
- **Pharmaceutical Products** such as medicaments containing penicillin, certain Chinese patent medicines etc.
- **Clocks and Watches** such as certain electrically operated clocks and watches, certain watch movements, cases, straps and other parts for clocks and watches etc.
- **Jewellery** such as articles of gold, silver and other precious metals and parts thereof, articles of pearl, precious and semi-precious stones etc.
- **Cosmetics** such as eye, lip, manicure and beauty make-up preparations, perfumes etc.
- **Metal Products** certain materials and articles of metals including steel, aluminium, copper etc.
- **Other Products** such as certain optical appliances and parts thereof, photographic cameras, ice cream, certain leather etc.

For other trade measures, the two sides agree not to take anti-dumping, countervailing and certain specific safeguard measures against goods of Mainland or Hong Kong origin. At the same time, the Mainland agrees not to apply tariff rate quotas against goods of Hong Kong origin.

### **On the provision of services**

Hong Kong Company engages in 17 sectors will benefit in terms of additional market access or removal of specific restrictions in the Mainland market. They include management consultancy, exhibitions and conventions, advertising, legal, accounting, medical and dental services, real estate and construction, transportation, distribution, logistics, forwarding, storage, tourism, audiovisual, banking, securities and insurance. A brief summary of the accession timeline and requirements for CEPA and the comparison with the WTO provisions, where possible, is attached as Table 1.

It is also important to note that in order to enjoy the preferential treatments granted under CEPA, Hong Kong Companies should meet the criteria of “service suppliers” as stipulated under the CEPA. However, companies should pay attention that definitions of “service suppliers” vary among different sectors, general determining factors are:

- Registered and established in Hong Kong;
- Company is in similar sector and scope of business in Hong Kong;
- The company must pay profits tax in Hong Kong. However, in case of a loss situation, the company will still meet the requirement if it can prove that it has engaged in substantive business in Hong Kong;
- The 3 – 5 years of substantive operations (depending on the industry) of the company in Hong Kong;
- The company must own or rent business premises in Hong Kong to engage in substantive operations; and
- Must employ in Hong Kong 50% or more of its total staff.

Additional requirements may be needed for special service sectors, e.g. shipping and banking. In view of this, companies shall evaluate their own position very carefully to see whether they meet the definition of qualifying “service suppliers” in a particular sector in order to enjoy the preferential treatments under CEPA.

### **With regard to trade and investment facilitation**

Both sides agree on promoting co-operations in 7 areas, namely, customs clearance; quarantine and inspection of commodities; quality assurance and food safety; stronger support for small and medium-sized enterprises; Chinese medicine and medical products; electronic commerce; trade and investment promotion; and transparency in laws and regulations.

CEPA liberalises the trade in goods and services as well as enhance the world leading position of Hong Kong as a global platform for China business. The current CEPA covers broad areas and many definitions and details will be supplemented as time goes by. Companies may want to re-visit their strategies in China in light of the CEPA, to take advantage of the special concessions given to Hong Kong products and Hong Kong Companies.

**Table 1****Brief Summary for CEPA and Comparison with WTO**

<b>Service sector</b>	<b>CEPA's accession requirements</b>	<b>WTO and national accession requirements</b>	<b>Remark</b>
1. Management consulting (other than legal, accounting, auditing and certification)	WFOE allowed on 1 Jan 2004	WFOE by 11 Dec 2007	4 years ahead
2. Convention services	WFOE allowed on 1 Jan 2004	Majority JV allowed	Higher foreign stakeholding percentage
3. Advertising services	WFOE allowed on 1 Jan 2004	WFOE by 11 Dec 2005	2 years ahead
4. Accounting services			Validity of "temporary audit business permit" extends from 6 to 12 months
5.1 Real estate	WFOE allowed on 1 Jan 2004	Not allowed to engage, in WFOE form, in activities relating to self-owned or leased properties for high standard real estate projects	Open high standard real estate market to HK companies
	WFOE allowed on 1 Jan 2004	Majority JV allowed for real estate development on a fee or contract basis	Higher foreign stakeholding percentage
5.2 Construction professional services	WFOE allowed on 1 Jan 2004	Majority JV now and WFOE by 11 Dec 2006	3 years ahead
5.3 Construction and professional engineering related services	Allowed 100% acquisition of domestic construction enterprises	Majority JV now and WFOE by 11 Dec 2004	1 year ahead
	No restriction on project type	JV is subject to restrictions on project type before 11 Dec 2004	Relaxed allowable business scope
	No restriction on project type	WFOE is subject to restrictions on project type even after 11 Dec 2004	Relaxed allowable business scope

Service sector	CEPA's accession requirements	WTO and national accession requirements	Remark
6. Medical and dental services			Qualified HK doctors can provide short term medical services for a max of 3 years as compared to 1 year in the past
7.1 Distribution services - Commission agents' services and wholesale services (excluding salt and tobacco)	WFOE allowed on 1 Jan 2004	Majority JV by 11 Dec 2003 and WFOE by 11 Dec 2004	1 year ahead. Lower entry requirements, for example, annual sales value requirement and registered capital etc. Wholly owned overseas trading companies allowed. Enterprises engaged in the distribution of books, newspapers, magazines, pharmaceuticals, pesticides, mulching film, chemical fertilizers, staple food, vegetable oil, edible sugar, cotton and processed oil remain subject to China's commitments under the WTO
7.2 Distribution services - Retail services (excluding tobacco)	WFOE allowed on 1 Jan 2004 (large department stores and chain stores more than 30 outlets still subject to minority equity)	Majority JV by 11 Dec 2003 (with geographical restrictions) and WFOE allowed by 11 Dec 2004 (large department stores and chain stores more than 30 outlets still subject to minority equity)	1 year ahead. Lower entry requirements, for example, annual sales value requirement and registered capital etc. Retailing companies allowed in all cities at prefectural level in the Mainland and at the county level in Guangdong Province. Individual owned retail stores by Hong Kong permanent residents of Chinese nationality are permitted in the Guangdong Province. Enterprises engaged in the distribution of books, newspapers, magazines, pharmaceuticals, pesticides, mulching film, chemical fertilizers, staple food, vegetable oil, edible sugar, cotton and processed oil remain subject to China's commitments under the WTO

<b>Service sector</b>	<b>CEPA's accession requirements</b>	<b>WTO and national accession requirements</b>	<b>Remark</b>
7.3 Distribution services - Franchising services	WFOE allowed on 1 Jan 2004	No foreign investment allowed until 11 Dec 2004	1 year ahead. Relevant regulations for franchising will be announced later
8. Logistics and certain types of related consultancy services	WFOE allowed on 1 Jan 2004	Different restrictions on transportation, storage and warehousing apply	
9. Freight forwarding agency services	WFOE allowed on 1 Jan 2004	Majority JV now and WFOE by 11 Dec 2005	2 years ahead and lower registered capital requirement.
10. Storage and warehousing	WFOE allowed on 1 Jan 2004 and follow capital requirement of domestic enterprises	Majority JV by now and WFOE by 11 Dec 2004	1 year ahead and lower capital requirement
11.1 Transport services - Road	WFOE allowed on 1 Jan 2004	Majority JV by now and WFOE by 11 Dec 2004	1 year ahead and permitted to provide direct non-stop road freight transport services between Hong Kong and each province in the Mainland. WFOE allowed in Western Region of the Mainland to provide road passenger transport services
11.2 Transport services - Marine	WFOE allowed on 1 Jan 2004	JV (stakeholding restriction depending on type of business)	Higher foreign stakeholding percentage
12.1 Tourism - hotels and restaurants	WFOE allowed on 1 Jan 2004	Majority JV now and WFOE by 11 Dec 2005	2 years ahead
12.2 Tourism - travel agency	No geographical location restriction	JV in Beijing, Shanghai, Guangzhou and Xian	
13.1 Audiovisual services - video and sound recording products distribution	Majority JV (not exceeding 70%) and allowed distribution of audiovisual products (including products on motion pictures)	Minority JV for distribution of audiovisual products (excluding products on motion pictures)	Higher foreign stakeholding percentage and relaxed business scope

Service sector	CEPA's accession requirements	WTO and national accession requirements	Remark
13.2 Audiovisual services - motion picture	No quota for Chinese language motion pictures produced by HK companies and motion pictures jointly produced by HK and the Mainland are to be treated as mainland movies	Importation quota for motion pictures	Enjoy national treatment
13.3 Audiovisual services - cinema theatre	Majority JV	Minority JV	Higher foreign stakeholding percentage
14. Legal services			Residency requirement for representatives of RO of a lawyer firm is relaxed. In Guangzhou and Shenzhen, such requirement is waived. Other practicing requirements are also relaxed
15. Banking	Asset requirement reduced to USD6 billion	Asset base requirement is USD20 billion (for branch) and USD10 billion (for JV or WFOE)	Relaxation of entry requirement
	No requirement for setting up RO prior to any investment in China entity and 2-year business history for RMB business	Required to set up RO prior to any investment in China entity such as JV bank and 3-year business history for RMB business application	Relaxation of entry requirement
16. Securities			HK Stock Exchange is allowed to set up a RO in Beijing.
17. Insurance	Investment cap for investment in domestic insurance enterprise is 15%	Investment cap for investment in domestic insurance enterprise is 10%	Market entry requirements remain the same, for example asset base is USD5 billion and 30-year business history and set up RO in China over 2 years, except that it can be met by way of strategic merger under CEPA

<b>Service sector</b>	<b>CEPA's accession requirements</b>	<b>WTO and national accession requirements</b>	<b>Remark</b>
Abbreviation: RO - Representative Office JV - Joint Venture WFOE - Wholly Foreign Owned Enterprise HK - Hong Kong Special Administrative Region			

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