



Doing Business in Hong Kong

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The law is as stated at 1 December 2006. Whilst every effort has been made to ensure the accuracy of this publication, it is for general guidance only and should not be treated as a substitute for specific advice. If you would advice on any of the issues raised, please speak to one of the contacts named on page 20.

Introduction

Hong Kong is a Special Administrative Region of the People's Republic of China that is governed by the Basic Law (**Basic Law**) which forms a mini constitution for Hong Kong. Under the *Basic Law*, Hong Kong enjoys a high degree of autonomy except in relation to matters such as defence and foreign affairs. It has its own executive, legislative and independent judicial power, including that of final adjudication. Socialist systems and policies will not be practised in Hong Kong for a period of 50 years commencing in 1997 under the principle of "one country two systems".

Hong Kong is an attractive place to do business and a leading international trading and service hub as well as a high value-added manufacturing base. It is one of the freest economies in the world and a gateway to investment in China.

The Hong Kong government practises an open and liberal investment policy and actively encourages inward investment. Generally, there are no tariffs or regulatory measures adversely affecting international trade.

Hong Kong's continuing success is largely due to a simple tax structure, low rates of tax, an excellent infrastructure and the government's firm commitment to free trade and free enterprise.

The following provides an overview of the various factors that a foreign investor should consider when establishing a business in Hong Kong.

Visas and Work Permits

Who requires an entry visa?

Every person who wishes to enter Hong Kong for employment, investment, education, training or residence is required to obtain the appropriate entry visa before coming to Hong Kong unless he or she:

1. is a Hong Kong permanent resident with a Hong Kong Permanent Identity Card;
2. has the right of abode in Hong Kong; or
3. has the right of unconditional stay in Hong Kong.

Sponsorship

Every applicant for an entry visa, irrespective of the category of visa, needs to have a sponsor.

In the case of an application for a visa for employment purposes, the Immigration Department usually insists that the employer act as the sponsor where the employer is a company.

Otherwise, the sponsor may be an individual, in which case the sponsor must have been a Hong Kong resident for at least three years.

The sponsor is required to certify that the applicant:

1. is a suitable person to be allowed into Hong Kong for the purpose stated;
2. will abide by the laws of Hong Kong; and
3. will leave Hong Kong on the expiration of the stay granted by the Immigration Department.

The sponsor must also undertake to assume responsibility for the applicant's repatriation to his or her original country of residency if, at the expiration of the stay granted by the Immigration Department, the applicant fails to leave Hong Kong. In addition, the sponsor must undertake to inform the Immigration Department of any change in the conditions of the applicant's stay in Hong Kong (e.g. cessation of the applicant's employment with the sponsor in Hong Kong).

Applications should be made through the sponsor before the applicant's arrival in Hong Kong, although in some cases the Immigration Department may accept applications made after the applicant has arrived in Hong Kong, in which case, the application will be a change of status application.

It is important to note that a change of status applicant may not work in Hong Kong until an employment visa is obtained.

Policies regarding employment visa

Under the existing immigration policy, a person seeking to enter Hong Kong for employment should possess a special skill, knowledge or experience of value which is not readily available in Hong Kong and show that he or she is not filling a post which can be filled locally.

Dependants of a person holding an employment visa are able to work in Hong Kong under the dependant's residency visa. Dependents that are subject to a condition of stay prohibiting employment which was imposed on them before 15 May 2006, may apply for cancellation of such condition so that they could take up employment in Hong Kong.

Types of Business Entities

General

A foreign investor has a wide range of business structures to choose from when doing business in Hong Kong. The type of entity the investor chooses will depend on what best suits the particular needs of the investor and his or her financial and tax considerations.

The most common business entities used by non-residents in Hong Kong include:

1. representative offices;
2. branches of parent companies;
3. subsidiaries of parent companies;
4. partnerships;
5. joint ventures; and
6. trusts.

Representative office

When a foreign company wishes to analyse the suitability of the Hong Kong market for its goods or services or both, a representative office can be opened. A company establishing a representative office may register under the *Business Registration Ordinance* but is not obliged to do so. This type of business entity is only permitted to carry on promotional and liaison work in Hong Kong. A representative office is prohibited from carrying on any

business in Hong Kong or entering into any contracts in Hong Kong. Once such a company commences the carrying on of a business, it is required to register under the *Business Registration Ordinance* and the *Companies Ordinance*.

Branch office

If a foreign company wishes to carry on business in Hong Kong and operate through a branch office, it must register the business under the *Business Registration Ordinance*. It must also register as an overseas company under the *Companies Ordinance*. To register under the *Companies Ordinance*, the foreign company will need to appoint a local person authorised to accept service of proceedings and notices in Hong Kong and have a registered place of business.

The branch will not be subject to limitations on the scope of its activities. However, certain types of business activities will require approvals and licences from other government authorities before the proposed business activities can begin. The registered foreign company will then be able to carry on business in Hong Kong.

Hong Kong subsidiary

A foreign company may wish to incorporate a wholly-owned Hong Kong subsidiary as a Hong Kong company. One advantage of a subsidiary arrangement is that it limits the liability of the parent company in relation to operations carried on by the Hong Kong subsidiary.

The subsidiary may be either a private company or a public company. Either type has unique advantages. Professional assistance should be sought to ensure that the most suitable corporate form is chosen.

The majority of subsidiary companies are private companies. Private companies are limited to a maximum of 50 shareholders, must have restrictions on the transfer of shares and may not issue shares in bearer form. Private companies are also subject to fund raising restrictions and must not engage in any activity that would require the lodgement of a disclosure document (e.g. a prospectus). A company may be incorporated with one member, and companies which are not part of a listed group may have a single director. The directors of a Hong Kong company are not required to be Hong Kong residents. Every Hong Kong incorporated company must have a company secretary, who must be resident in Hong Kong.

Partnership

Partnerships are comparatively inexpensive to establish and can be formed quickly. The agreement creating the partnership does not need to be registered, but the partnership itself requires registration under the *Business Registration Ordinance* once it establishes a place of business in Hong Kong.

Each partner is jointly liable with all the other partners for all debts and obligations of the partnership incurred while he or she is a partner.

The size of partnerships is limited to 20 members. However, an exception is allowed for certain types of professional partnerships.

Joint venture company

This is a normal company used to carry on the joint venture activity on behalf of its shareholders. This type of business structure is an entity which is legally distinct from the

parties which comprise it. It is used where a number of parties wish to carry on business together. The component parties' liability is limited to their share of capital investment in the joint venture company. The formalities for establishment are similar to those for a subsidiary company.

Trusts

While not commonly used in Hong Kong in this way, a trust can be utilised as a business vehicle or as an investment vehicle whereby a trustee conducts the trust's business on behalf of the "members" (known as beneficiaries) of the trust. The trustee may be a company (usually a private company) created for this purpose. The income generated will belong to the beneficiaries of the trust. The rights and duties of the trustees are set out in the trust deed.

A trust is not a separate legal entity. The trustee can assume obligations as trustee and is allowed to use trust assets to satisfy its debts and obligations as trustee as provided for in the trust deed.

Shelf companies

Shelf companies are "ready made" companies, waiting to be purchased. Shelf companies, therefore, offer an immediate solution to an urgent requirement for a company, as it usually takes an average of seven to 10 working days to incorporate a company in Hong Kong.

A shelf company would not come with the name and specific provisions in the Memorandum and Articles of Association which may be required, but these matters may be changed subsequent to the acquisition.

The Stock Exchange of Hong Kong Limited

Investors may wish to consider raising local equity by listing on The Stock Exchange of Hong Kong Limited (**Exchange**). This avenue is also available to companies from some jurisdictions incorporated outside Hong Kong. The Exchange serves a wide array of international and domestic investors and end users, including many of the world's largest financial institutions.

Potential investors should ask their legal adviser for a thorough outline of the current listing rules.

Business Environment

General

During the last 20 years, Hong Kong's economy has nearly trebled in size with GDP growing in real terms at an average annual rate of 5.3%. Over the same period, Hong Kong's per capita GDP has doubled, giving an annual average growth rate of 4% in real terms.

Hong Kong is characterised by a high degree of internationalisation, business-friendly environment, open and fair competition, free flow of information, well-established and comprehensive financial network, superb network of transport and telecommunications infrastructure, sophisticated support services and a well-educated work force complemented by a pool of efficient entrepreneurs.

It also has a substantial amount of foreign exchange reserves, a fully convertible and stable currency, no exchange controls and a simple tax system with tax being levied at a low rate.

Direct investment

Hong Kong is the second most favoured destination for inward direct investment in Asia, second only to mainland China. The stock of inward direct investment into Hong Kong at the end of 2004 amounted to HK\$3,521.90 billion, equivalent to 254% of the GDP of Hong Kong.

Services sector

The services sector has flourished and diversified into types of activities in line with the structural transformation of the economy. Trade-related and tourism-related services, community, social and personal services and finance and business services such as banking, insurance, real estate and a host of related professional services have all grown substantially over the past two decades. There has also been strong expansion in information technology, especially telecommunications services and Internet applications in line with the shift in economic structure towards a knowledge-based economy.

Manufacturing sector

Manufacturing businesses in Hong Kong are renowned for being versatile and flexible. The existence of many small establishments connected under an extensive local subcontracting network has facilitated producers in coping with changing conditions in overseas markets. By increased outward processing arrangements in mainland China, Hong Kong's capacity has been substantially expanded, helping to maintain the price efficiency of its products, most of which are destined for export.

Intellectual property rights

Sources of intellectual property law

Hong Kong is a common law jurisdiction and the fundamentals of the intellectual property regime have been inherited from the English system, which was followed until the reversion of sovereignty in 1997. Intellectual property rights in Hong Kong, including patents, designs, trade marks and copyright, predominantly derive from legislation. However, as in other common law jurisdictions, the judiciary has developed, through precedents, remedies such as the tort of passing-off, malicious falsehood (trade libel) and breach of confidence. There are no generic unfair competition or fair trading laws.

Hong Kong intellectual property law (post-1997)

At midnight on 30 June 1997, Hong Kong ceased to be a colony of the United Kingdom and sovereignty reverted to China. In terms of the *Basic Law*, which governs Hong Kong's status as a Special Administrative Region of the People's Republic of China, Hong Kong remains as a separate jurisdiction from the rest of China for intellectual property purposes. The intellectual property laws of the People's Republic of China, therefore, do not apply in Hong Kong and vice versa.

Trade marks

Hong Kong has had an independent trade mark registration system for well over 100 years. The Hong Kong Trade Marks Registry opened its doors in 1873 – two years before the United Kingdom Trade Marks Registry was established. Although it is based closely on the

United Kingdom *Trade Marks Act 1994*, the current Hong Kong *Trade Marks Ordinance* (which came into force in 2003) is an independent piece of legislation. The Hong Kong *Trade Marks Ordinance* places emphasis on the first-to-file system followed in China, which is a departure from the practice under the previous law. The Ordinance specifically recognises rights in well-known trade marks consistent with Hong Kong's obligations under the *Paris Convention for the Protection of Industrial Property*.

Patents

There is a separate Hong Kong patent regime as Chinese patents do not automatically cover Hong Kong. The Hong Kong *Patent Law* provides a re-registration system under which patents originally filed in China, the United Kingdom or the European Community (designating the United Kingdom) may be protected in Hong Kong. The resulting Hong Kong patent is completely independent. It may, therefore, be amended or revoked in Hong Kong independently of the basic patent. A separate utility model or "short-term patent" system has also been established in Hong Kong. Such applications are filed directly in Hong Kong.

Semiconductor topography protection

The layout of semiconductor circuitry is protected by the *Layout-Design (Topography) of Integrated Circuits Ordinance*, which was enacted in 1994. This provides a copyright-like protection for integrated circuits created after the coming into force of the *Ordinance*.

Registered designs

The *Registered Designs Ordinance 1997* came into force on 27 June 1997 and ushered in a new era in Hong Kong's intellectual property administration. It replaced the regime which was based on the United Kingdom *Designs (Protection) Ordinance* and introduced an independent design regime to Hong Kong for the first time. The substantive law of the *Ordinance* generally follows the steps of the United Kingdom's *Registered Design Act 1949*. The main differences are that the Hong Kong *Ordinance* allows for protection of multiple designs under a single application and worldwide novelty is required. A Hong Kong registered design has a maximum life of 25 years from filing, subject to the payment of renewal fees every five years.

Conclusion

Hong Kong is generally regarded as having a comprehensive system for the protection of intellectual property rights. The government has put considerable effort into ensuring that this perception is maintained. In this context, all of Hong Kong's major intellectual property legislation has been overhauled within the last few years and, as a result, Hong Kong's laws are, for the most part, consistent with internationally accepted standards.

Franchising

Hong Kong has no regulatory regime applicable to franchising, thereby enabling overseas franchisors to enter the Hong Kong market with minimum formalities and regulatory compliance. Franchise agreements are, however, subject to various consumer protection rules, including restrictions that apply to contracts generally, such as restrictions on exemption clauses, unconscionable provisions and restrictions on unreasonable restraints of trade.

Foreign Investment Policy

Investment possibilities generally

Foreign investment plays a key role in the Hong Kong economy. Various sources of foreign investment like China, Japan, the United States and the United Kingdom have substantial amounts of inward direct investment in Hong Kong. On the one hand, no industries in Hong Kong are closed to foreign investment. On the other hand, it is not only permitted but quite common to have 100% foreign investment in most industries. As at 1 January 2005, 3,798 companies had set up their headquarters or regional offices in Hong Kong, an increase of 5.2% compared with 2004.

Government attitude

The Hong Kong government upholds a free and open market policy which generally applies to all trade and investment, with very few restrictions on foreign investment. Whilst there are no specially enacted incentives for foreign investment, all foreign companies benefit from the government's policy of providing an appealing climate for investment through its physical infrastructure including good communications, efficient port and airport facilities, its simple tax structure with low rates of tax, and its legal and administrative system. It promotes fair competition and does not discriminate between foreign and domestic investors.

In terms of international recognition, Hong Kong is consistently described as the world's freest economy by highly reputable international institutions.

Gateway to mainland China

The fast expanding China market, especially after China's accession to the World Trade Organisation (**WTO**) and its continued reduction in administrative barriers to trade, has been highly attractive to foreign investors. Given the geographic proximity and business synergies between Hong Kong and mainland China, many foreign companies find it advantageous to choose Hong Kong as their base and a service platform for investment in China. What makes Hong Kong an even easier route into and out of China recently is the mainland China Hong Kong Closer Economic Partnership Arrangement (**CEPA**) of June 2003. It came into effect on 1 January 2004 and grants easier access to mainland markets for Hong Kong-made products and Hong Kong-based companies in various sectors. The measures in CEPA are above and beyond China's WTO commitments, which phase in tariff cuts and market liberalisation measures in their entirety three to six years after WTO accession.

An overseas manufacturer is not required to establish itself a presence in Hong Kong to take advantage of CEPA but must enter into a joint venture with, or outsource production to, a Hong Kong manufacturer. An overseas service company may also be eligible for CEPA benefits one year after its merging with, or acquisition of at least 50% of, a Hong Kong service supplier. CEPA will therefore strengthen the appeal to foreign companies of Hong Kong's position as a service hub and global platform for China business, and in turn an incentive for foreign investment in Hong Kong.

Foreign investment restrictions

The Hong Kong government in general makes no distinction between local and foreign companies, and welcomes investment from both. Hong Kong does not subject foreign

investments to special regulatory regimes or requirements. Foreign companies setting up operations in Hong Kong do not face any special approval procedures and the procedural requirements are not materially different from those for the local counterparts. Funds from profit or capital accounts may be freely repatriated and remitted overseas and there is no foreign exchange control.

100% foreign ownership of companies is generally permitted and common in Hong Kong, with very few foreign investment restrictions. The table below sets out the business sectors where foreign investment restrictions or limitations are in place:

Sector	Foreign investment restriction related regulations/situation
Banking	Foreign banks in Hong Kong are common and free to operate with limited restrictions. They have been allowed to establish as many branches as they wish to since November 2001. A number of market entry criteria have been relaxed in May 2002 - the lowering of the minimum asset size and the lifting of the requirement to have maintained a local representative office for a period of one to two years before its authorisation request are examples.
Civil Aviation	Generally no foreign ownership restrictions. Control over international airlines serving Hong Kong is shared with the Chinese government. Arrangements for air services between Hong Kong and other parts of mainland China are made by the Chinese government in consultation with the Hong Kong government.
Television Broadcasting	Control over the licensees of domestic free TV programme services by foreign investors may not exceed 49%. Prior approval is required for the holding, acquisition or exercise of voting control by foreign investors of 2% or more of a television licensee.
Sound Broadcasting	Control over sound broadcasting licensees by foreign investors may not exceed 49%.

Government Initiatives and Incentives

General

Given the tax environment in Hong Kong and in particular:

1. generally lower rates of tax than most other Asian jurisdictions;
2. no tax on capital gains;
3. no tax on profits arising in or derived from outside Hong Kong;
4. no tax on dividends; and
5. abolition of estate duty.

Hong Kong does not have an extensive regime of tax incentives designed to attract foreign investment. There are, however, a number of exemptions from tax or allowances designed to stimulate particular industries or new investments in existing businesses.

Exemptions

Important exemptions include:

1. deposit interest from bank deposits paid to corporations (other than financial institutions) and individuals carrying on business in Hong Kong;
2. interest income and trading profits derived from qualifying debt instruments are subject to a concessionary tax rate of half of the normal rate or are exempt. Qualifying debt instruments must be cleared through the Hong Kong Monetary Authority, have a suitable credit rating, a maturity period of three years or more and be of a minimum denomination of HK\$50,000;
3. profits on all debt instruments with a maturity period of seven years or more will be tax exempt; and
4. exemption of offshore funds from profits tax.

Allowances

Important allowances include:

1. an initial allowance of 20% of the cost (excluding land cost) of an industrial building for the purpose of a qualifying trade (which includes mills, factories or similar premises, certain utility undertakings, manufacturing, storage, farming and scientific research). An annual allowance of 4% of the original capital expenditure is also given. Balancing allowances or balancing charges may be made in the tax year in which the building is sold;
2. an annual allowance of 4% is available for commercial buildings or structures used other than for industrial purposes;
3. capital expenditure on the renovation or refurbishment of a building other than a domestic building is deductible at the rate of 20% a year over a five year period; and
4. an initial allowance of 60% of the capital expenditure on machinery or plant is available in the year in which the expenditure is incurred. Annual allowances at prescribed rates are available in subsequent years on the reducing value.

A more generous 100% allowance of capital expenditure on prescribed fixed assets is allowed. This covers certain machinery or plant used specifically and directly for any manufacturing process, computer hardware, computer software and computer systems. It does not apply to leased assets.

Taxation

General

The principal sources of revenue to the Hong Kong Government (apart from revenue from the sale of government land) are:

1. salaries tax;
2. profits tax;
3. property tax; and

4. stamp duty.

Tax is charged according to the nature of the relevant income and is on a territorial basis. Income not covered by any of the above taxes is not subject to tax in Hong Kong. In particular, Hong Kong does not impose any payroll, turnover, sales, value added, gift or capital gains taxes or any estate duty or inheritance tax. Consideration is presently being given to introduction of a goods and services tax.

There are various indirect taxes. The most significant of these are duties on hydrocarbons, tobacco and liquor, and fees for vehicle registration and licensing.

Salaries tax

A person is subject to salaries tax on his or her Hong Kong sourced employment income, income from an office in Hong Kong or a Hong Kong pension. If the employment is a Hong Kong employment, all income derived from it will normally be subject to salaries tax even if some services are performed outside Hong Kong.

Income from a non-Hong Kong employment is only taxed to the extent of income derived from services rendered in Hong Kong. A non-Hong Kong employment would be one where the employment contract was negotiated and entered into outside Hong Kong, where it is enforceable outside Hong Kong, where the employer is resident outside Hong Kong and remuneration is paid outside Hong Kong.

No account is taken of visits to Hong Kong by persons with a non-Hong Kong employment not exceeding 60 days in any fiscal year.

Perquisites are generally taxable but where the employer has the primary liability for payment of benefits they may not be. Perquisites by way of educational allowance or vacation allowance are taxable.

Housing which is provided by an employer is taxable but on a concessionary basis.

An employer is not required to withhold salaries tax (with limited exceptions in relation to persons about to leave Hong Kong) but he or she must make an annual return of remuneration paid to employees and must make various other returns e.g. on commencement or termination of employment or departure of the employee from Hong Kong.

Collection of tax is by way of provisional assessment based on the previous year's salary and final assessment on filing of the tax return for the year in question. The provisional tax is credited against final tax payable, with any over payment being refunded or under payment being charged.

The basic rate of tax is 16%. However, tax payable is calculated with various personal allowances and tranches of income at different rates of up to 19%, but if on calculating the tax payable based on these allowances and tranches the amount charged would exceed 16% of total income liable to salaries tax, then the tax will be charged at 16% of income liable to salaries tax.

Profits tax

A person who carries on a trade, profession or business in Hong Kong is chargeable to profits tax on the profits which arise in, or derive from, Hong Kong from that trade, profession or business other than profits from the sale of capital assets. Profits sourced outside Hong Kong

are not taxed in Hong Kong even if remitted to Hong Kong. Residence of the taxpayer is irrelevant for profits tax purposes.

Whether profits are sourced in Hong Kong is a question of fact. The courts apply an operations test to determine this. They look to the operations of the taxpayer which gave rise to the profit and where those operations took place.

Dividends are not subject to profits tax, nor is any tax required to be withheld from them.

Certain kinds of profit are deemed to be taxable in Hong Kong. These include:

1. fees for exhibition or use in Hong Kong of films or tapes or sound recording;
2. royalties for use of intellectual property rights in Hong Kong and, in some circumstances, outside Hong Kong;
3. grants, subsidies or financial assistance to a business carried on in Hong Kong;
4. rentals for use of property in Hong Kong;
5. interest accruing to a financial institution through, or from its business in, Hong Kong and profits made by a financial institution on sale or redemption of certain commercial paper;
6. interest received in respect of the funds of a business carried on in Hong Kong not being otherwise exempt;
7. Hong Kong sourced profits on sale or redemption of certain commercial paper, except in a non-business context; and
8. consideration for the transfer of certain rights to receive income from property.

Expenses incurred in production of taxable profits are allowed irrespective of source. Certain specific types of deductible and non-deductible expenses are set out in the *Inland Revenue Ordinance*.

Tax losses are deductible from profits arising in the year of assessment and may be carried forward to future years to the extent not used. Group tax relief is not permitted.

Tax paid by financial institutions, insurance companies, shipowners and aircraft operators are subject to special rules.

Tax is collected by way of provisional assessment based on the previous year's profits and final assessment on filing of the tax return for the year in question. The provisional tax is credited against final tax payable, with any over payment being refunded or under payment being charged.

The rate of profits tax is 17.5% for corporations and 16% for taxpayers other than corporations.

Property tax

Property tax is charged at the rate of 16% of the assessable value of any land or buildings in Hong Kong.

The assessable value is the rent receivable less any rent which has become irrecoverable, less rates paid and less a fixed allowance of 20% for repairs.

Corporations carrying on business in Hong Kong can elect to be exempted from property tax and subject instead to profits tax.

Collection is by way of provisional assessment based on the previous year's rent and final assessment on the filing of the tax return for the year in question. The provisional tax is credited against final tax, with any over payment being refunded or under payment being charged.

Estate duty

Legislation has now been passed abolishing estate duty. Although complete abolition came into effect for deaths on and after 11 February 2006, it was retrospective to so the extent that a maximum of HK\$100 of estate duty was payable on the estates of persons dying on or after 14 July 2005.

Stamp duty

Stamp duty is charged on the following documents:

1. conveyances on sale of property - 3.75% of the consideration payable (with lower rates applicable to a consideration of HK\$6,000,000 or below);
2. agreements for sale and purchase of property - 3.75% of the consideration (with lower rates applicable to a consideration of HK\$6,000,000 or below);
3. leases of property exceeding one year - 0.5% of the average yearly rent;
4. leases of property exceeding three years - 1% of the average yearly rent;
5. transfers of Hong Kong stock - 0.2% of the consideration or the value of the shares, whichever is higher; and
6. Hong Kong bearer instruments - 3% of the market value.

Exemption is available for transfers of property or shares between associated companies. Companies are associated if they have a 90% shareholding link.

The following are exempt from duty:

1. stock lending;
2. transactions by market makers for hedging options transactions in the ordinary course of acting as a market maker; and
3. transactions in regional derivative options and convertible bonds or notes.

Workplace Relations

General

The workplace relations climate in Hong Kong is, generally speaking, very stable and hence favourable for foreign investors.

Hong Kong employees have always been and continue to be committed to making their industries internationally competitive. As Hong Kong progresses to a knowledge-based economy, the nature of work, workplaces and workplace practices are being aligned to the new demands of the economy.

Hong Kong's combination of a highly educated, skilled and dedicated workforce is very appealing to foreign investors.

The government recognises the need to promote good employer-employee relations and enhance the rights and benefits of employees in a way commensurate with Hong Kong's socio-economic development. Considerable importance is also attached to health and safety at work.

The Labour Department implements labour policy and labour legislation for the promotion of harmonious labour relations and safeguarding employees' rights and benefits. It also provides free employment services to employers and job seekers.

Employment conditions

Employment conditions are usually provided for in the contracts of service entered into between employers and employees and/or in the collective agreement entered into between employers and the trade unions representing these employees. For employees who fall within the ambit of the *Employment Ordinance (Ordinance)*, the provisions of the *Ordinance* must be observed to the extent that it sets out certain basic employment conditions that would apply on a mandatory basis.

Depending on the particular industry/employer, there are also trade unions that negotiate workplace agreements between employers and employees.

Employment Ordinance

General

The *Ordinance* is the main legislation prescribing the minimum rights, benefits and protection for employers and employees in Hong Kong. Under the *Ordinance*, the employer and the employee cannot contract out of the minimum rights, benefits and protection given to the respective parties by the *Ordinance*.

Who does the *Ordinance* apply to?

The *Ordinance* applies to every employee engaged under a contract of employment in Hong Kong with only limited exceptions. These exceptions include:

1. employees who are family members living with the employers;
2. certain employees working outside of Hong Kong; and
3. apprentices.

Whether an employment relationship exists is a matter of fact.

Minimum protection

All employees covered by the *Ordinance*, irrespective of their hours of work, are entitled to basic protection under the *Ordinance* including (but not limited to) payment of wages, restrictions on wage deductions and the granting of statutory holidays.

Employees who are employed under a continuous employment contract are further entitled to benefits such as rest days, paid annual leave, sickness allowance, severance payment and long service payment.

Continuous employment

Under the First Schedule of the *Ordinance*, an employee is deemed to have been continuously employed if he or she has been employed under a contract of employment for a period of four or more weeks, each week working for no less than 18 hours. Certain breaks such as maternity leave and sickness days are deemed not to interrupt the continuity of employment.

Employee protection/benefits

Employees employed under a continuous contract are entitled to the following:

Rest days

Employees are entitled to not less than one rest day every seven days. These rest days shall be appointed by the employer, which may be granted on a regular or irregular basis.

Annual leave

Employees are entitled to paid annual leave ranging from a minimum of seven days to a maximum of 14 days, depending on their length of service.

Maternity leave and pay

All female employees are entitled to maternity leave of 10 weeks and those who have been employed under a continuous contract for a minimum qualifying period (i.e. 40 weeks) are entitled to be paid during maternity leave. A pregnant employee may decide to commence her maternity leave from two to four weeks before the expected date of confinement, with the agreement of her employer. Maternity leave pay is currently paid at the rate of four-fifths of the employee's normal wages.

Sickness allowance

Employees are currently entitled to paid sickness leave at the rate of four-fifths of their normal wages. Sickness days accrue at the rate of two paid sickness days for each completed month of employment during the first 12 months of employment and four paid sickness days for each month of employment thereafter, up to a maximum of 120 paid sickness days. The entitlement to sickness pay applies only if the sickness leave taken is not less than four consecutive days.

Severance payment

An employee who has been employed under a continuous contract for 24 months or more and is dismissed by reason of redundancy or lay-off is entitled to a severance payment. The amount of the severance payment is two-thirds of the employee's last full month's wages or two-thirds of HK\$22,500, whichever is less, for each year of service. The current maximum severance payment payable is HK\$390,000. The amount of any gratuity or retirement scheme payment to the employee, based on length of service, is deductible from the amount of severance payment entitlement. In the case of a retirement scheme payment, only the employer's contributions (and interest thereon) may be deducted.

Long service payment

An employee who has been employed under a continuous contract for five years or more and is dismissed for any reason other than redundancy or misconduct is entitled to a long service payment on termination of employment by the employer. An employee who has been paid a severance payment will not be entitled to a long service payment.

The calculation of long service payment is the same as severance payment and is also subject to the same maxima as stated above. The amount of any gratuity and retirement scheme payment paid to the employee, based on length of service, is deductible from the amount of long service entitlement, as in the case of severance payment.

End of year payment

For every employment contract made after 27 June 1997, it is presumed that an annual payment or annual bonus (if provided) is not of a gratuitous nature and is payable only at the discretion of the employer unless a written term or condition in the contract expresses intention to the contrary.

Prohibition from making deductions from wages

In general, employers are not allowed to make deductions from the wages of an employee. There are, however, a number of limited exceptions. These exceptions include deductions:

1. for absence from work;
2. for damages or loss of goods or equipment belonging to, or in the possession or control of, the employer or expressly entrusted to an employee for custody where such damage or loss is directly attributable to the employee's neglect or default;
3. for meals supplied by the employer at the request of the employee;
4. for accommodation provided by the employer and occupied by the employee or the family of the employee;
5. for recovery of any advance or over-payment of wages made by the employer to the employee;
6. for any loan owed by an employee with the written consent of the employee;
7. for any medical benefit scheme, superannuation scheme, retirement scheme or thrift scheme of which the employee is a member;
8. authorised by an enactment of law;
9. approved by the Commission for Labour; and
10. in respect of any payment that an employee would be liable to pay for wrongfully terminating an employment contract.

All other deductions not listed above are unlawful. An employer who makes unlawful deductions commits a strict liability offence and will be liable to a fine of HK\$100,000 and imprisonment for one year.

Definition of wages

Wages under Hong Kong law means all remuneration, earnings, allowances, tips and service charges, however designated or calculated, payable to an employee in respect of work done or work to be done. Allowances including travelling allowances, attendance allowances, commission and overtime payment are within the definition, but the following are excluded:

1. the value of any accommodation, education, food, fuel, light, medical care or water provided by the employer;
2. any contribution paid by the employer on his or her own account to any retirement scheme;
3. any commission which is of a gratuitous nature or which is payable only at the discretion of the employer;
4. any attendance allowance or attendance bonus which is of a gratuitous nature or which is payable only at the discretion of the employer;
5. any travelling allowance which is of a non-recurrent nature;
6. any travelling allowance payable to the employee to defray actual expenses incurred by him or her by the nature of his or her employment;
7. the value of any travelling concession;
8. any sum payable to the employee to defray special expenses incurred by him or her by the nature of his or her employment;
9. any end-of-year payment or any proportion thereof;
10. any annual bonus which is payable by the employer at his or her discretion; and
11. any gratuity payable on completion or termination of employment.

Overtime pay which is of a consistent character or the monthly average of which over the past 12 months is 20% or more of the average monthly wage of the employee during the same period should also be included in calculating wages.

Termination

General

The employment of an employee on probation may be terminated by the employer or the employee without notice during the first month and with at least seven days' notice after the first month. In all other cases, unless summarily dismissed for good cause, the employee is entitled to:

1. at least one month's notice of termination where the contract does not provide for the length of notice required to terminate the contract; or
2. seven days or the agreed period, whichever is the longer, where the length of notice of termination is provided for in the contract.

Alternatively, a contract of employment can be terminated without notice by making a payment in lieu of notice equal to the amount of wages which would have accrued to the employee during the requisite period of notice.

Statutory restrictions on termination of employment contract

The *Ordinance* provides that it is unlawful for an employer to dismiss an employee under the following circumstances:

1. a female employee who has been confirmed pregnant and has served a notice of pregnancy (up till and including the day she is due to return to work on the expiry of her maternity leave or the date of cessation of pregnancy);
2. an employee who is on a day in which a sickness allowance is paid;
3. an employee by reason of his or her giving of evidence or information in any proceedings or inquiry;
4. an employee for trade union membership and activities; or
5. an injured employee before having entered into an agreement with the employee for employee's compensation or before the issue of a certificate of assessment.

Employers should also ensure that employees are terminated only for valid reasons as provided under the *Ordinance*.

Termination payments

Termination payments may differ depending on the length of service and the reason for termination. These payments will usually include the following:

1. outstanding wages;
2. notice/wages in lieu of notice (if any);
3. payment in lieu of any untaken annual leave and any pro rata annual leave pay for the current leave year;
4. any outstanding sum of end of year payment and pro rata end of year payment for the current payment period (if any);
5. where appropriate, long service payment or severance payment; and
6. other payments under the employment contract, such as gratuity, provident fund, etc.

Other issues

Insurance coverage

Employers are required to maintain insurance coverage in respect of employees employed in Hong Kong pursuant to the *Employees Compensation Ordinance* in respect of work-related injuries, but there is currently no statutory requirement to provide medical benefits.

Mandatory provident fund

The *Mandatory Provident Fund Schemes Ordinance*, which commenced operation on 1 December 2000, requires both the employer and the employee to contribute 5% of the employee's salary into a mandatory provident fund scheme. The current maximum level of mandatory contribution required is HK\$1,000 paid each month by both the employer and the employee. The employer and/or the employee may make additional voluntary contributions to the scheme if they wish.

Taxation

Employers are required to notify the Inland Revenue Department of the commencement and cessation of employment of its employees within a prescribed time.

Discrimination

The implementation of the *Sex Discrimination Ordinance*, *Disability Discrimination Ordinance* and the *Family Status Discrimination Ordinance* in Hong Kong makes any discrimination in the workplace by reason of a person's gender, marital status, pregnancy, disability or family status unlawful. These Ordinances also make other forms of discrimination including victimisation, sexual harassment, disability harassment and vilification unlawful.

Currently, only discrimination as described above is unlawful. It is therefore strictly speaking not unlawful for an employer to discriminate on some other basis such as a person's age, physical appearance, height, race, educational attainment, political beliefs or social skills. However, the Equal Opportunities Commission is seeking to make discrimination on some or all of these grounds unlawful.

Dispute Resolution

Courts

The Court system is in essence the same as that which existed prior to reunification in 1997. It is largely based on the English Court system although, after 1997, the final appellate court was changed from the Privy Council in London to the Court of Final Appeal in Hong Kong. The judiciary operates on the same principle fundamental to the common law system, namely the principle of the independence of the judiciary from the executive and legislative branches of government.

The Court system operates efficiently and is the normal avenue for the settlement of disputes in Hong Kong.

Enforcement of Hong Kong judgments abroad is largely based on reciprocity of enforcement in Hong Kong. On this basis, enforcement of Hong Kong judgments is possible in Commonwealth and various other jurisdictions.

Arbitration

Arbitration has also been a popular method of dispute resolution for a number of years. The system is based on a domestic regime derived from English law and an international regime which reflects the UNCITRAL Model Law.

Awards made in Hong Kong can be enforced in 135 jurisdictions under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

The Hong Kong International Arbitration Centre provides an independent and impartial focus for the development of dispute resolution in Hong Kong and the Asia Pacific Region. It provides information on dispute resolution and a panel of arbitrators and accredited mediators.

Arbitration is a popular mode of dispute resolution where the matter in issue is of a technical nature, such that there are advantages of having an adjudicator with relevant technical expertise.

Contacts

Deacons

Deacons is a leading business law firm with a network of affiliated firms comprising over 900 legal professionals across Asia. We provide an extensive range of legal and commercial services to local and international corporations with business interests throughout this region. With 155 years of experience in providing legal services, our clients are assured of the integrity and stability of one of the region's oldest and most respected law firms.

Beyond Hong Kong and the People's Republic of China, Deacons has established offices or affiliates in Australia, Indonesia, Malaysia, Singapore, Taiwan and Thailand, ensuring we are conveniently located to provide market-sensitive legal advice. Our principal service areas include Banking & Finance, China Trade & Investment, Communications & Technology, Company Formation & Corporate Services, Construction & Arbitration, Corporate Finance & Capital Markets, Entertainment & Media, Financial Services, Human Resources & Pensions, Insolvency & Restructuring, Insurance, Intellectual Property, Japan Services, Litigation, M&A and Commercial, Private Equity & Venture Capital and Property.

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Whilst every effort has been made to ensure the accuracy of this publication, it is for general guidance only and should not be treated as a substitute for specific advice. If you would like advice on any of the issues raised, please speak to any of the contacts listed.

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