Hong Kong thrives as an international business and financial centre under the Basic Law

Introduction

Hong Kong has been ranked the world's freest economy 24 years in a row since the Heritage Foundation published the Index of Economic Freedom in 1995. In 2017, Hong Kong was the third largest recipient of foreign direct investment worldwide according to the United Nations World Investment Report 2018, only after the United States and Mainland China.

Hong Kong is also an important banking and financial centre in the world. The Global Financial Centres Index, which measures the competitiveness of financial centres, ranks Hong Kong first in Asia and third globally in 2018, just after New York and London. As at the end of September 2018, there were 187 banks and other deposit-taking institutions in Hong Kong. Out of the largest 100 banks in the world, 70 have operations in Hong Kong. In terms of Initial Public Offering funds raised, Hong Kong has ranked first globally for five years during the nine-year period since 2009.

Why does the HKSAR, a compact city with a size of about 1,100 sq km, continue to attract capital and talents from all over the world? The answer may be found in the Basic Law, which is our treasure trove. Many features of our free capitalist economy may often be taken for granted, but the underlying Basic Law guarantees and requirements, which have sometimes gone unnoticed, are indispensable to the success of our city.

The Basic Law, enacted by the NPC of the PRC in 1990, reflects the basic policies of the PRC regarding the HKSAR, and entrenches the principle of "one country, two systems". Through the Basic Law, the NPC authorizes the HKSAR to exercise a high degree of autonomy, thereby allowing the HKSAR to maintain a capitalist system different from the socialist system practised in the Mainland.

The Basic Law preserves our common law system and capitalist economy. In this regard, the Basic Law, particularly its Chapter V, provides the HKSAR with an unprecedented degree of autonomy in the conduct of its economy, and is the keystone ensuring the city's continued success. Chapter V enables the HKSAR to practise an independent taxation system and have independent finances separate from the rest of China. It also gives the HKSAR the mandate to maintain its own currency, to be a free port and to pursue free trade policy.

Importance of the Basic Law for the HKSAR's status as an international business centre

Our low tax policy

Chapter V of the Basic Law embeds various important economic policies underlying Hong Kong's successful capitalist economy. One of them is its low tax policy. Pursuant to BL 108, the HKSAR shall practise an independent taxation system and shall take the low tax policy previously pursued in Hong Kong as reference. BL 108 and other articles in Chapter V such as BL 106 operate as a "fiscal firewall" making Hong Kong's public finances completely separate from those of the Mainland. Hong Kong has always practised a simple and low tax system which is pivotal to the city's success as an international business centre. Hong Kong

adopts a territorial source principle of taxation, that is, only incomes generated in Hong Kong are taxable. Also, only three direct taxes are imposed in Hong Kong and there are generous allowances and deductions. The three direct taxes are:

- profits tax with a maximum rate of 16.5 percent for corporations. For unincorporated businesses (i.e. partnerships and sole proprietorships), the maximum rate is 15 percent;
- salaries tax with a maximum limit of 15 percent;
- property tax with a flat rate of 15 percent.

Since 1 July 1997, the HKSAR has adopted various measures to further lower the tax burden of businesses and individuals and to bolster Hong Kong's competitive edge in the global market. In 2005, the abolition of estate duty was proposed in the Budget Speech and the Revenue (Abolition of Estate Duty) Ordinance 2005 came into effect in 2006 to implement the proposal. Over the years, we have also put in place a range of tax incentives for the fund industry. These foster a favourable environment in Hong Kong for the development of the asset and wealth management industry. In terms of asset management business, Hong Kong is the top market in Asia. At the end of 2017, our asset and wealth management business amounted to HKD 24.3 trillion (USD 3.1 trillion).

As a further example of Hong Kong's low tax policy, the duty on wine has been removed since February 2008. The duty waiver has provided strong impetus for the growth of Hong Kong's wine trading and related businesses, and has been instrumental in establishing Hong Kong as a regional wine trading and distribution hub. In 2017, imports of wine amounted to about HKD 12 billion, representing an increase of 6.5 times over that in 2007, the year before the removal of wine duty. Hong Kong has been one of the largest wine auction centres in the world since 2009, with auction sales amounting to USD 97.8 million in 2017.

In recent years, new profits tax concession measures have also been introduced to strengthen Hong Kong's status as a global business and financial centre. For instance, the Inland Revenue (Amendment) (No. 3) Ordinance 2017, enacted in July 2017, provides tax concessions to qualifying aircraft lessors and qualifying aircraft leasing managers in Hong Kong. In general, qualifying aircraft lessors are entitled to a tax concession under which only 20% of the net lease rentals are

assessed. The profits derived by qualifying aircraft lessors and qualifying aircraft leasing managers from qualifying activities are charged at 8.25%, i.e. one-half of the corporate profits tax rate.

Hong Kong is committed to encouraging the establishment of captive insurers[1] in the city with a view to promoting Hong Kong as a captive centre within the Asian Region. To attract more local and foreign enterprises to form captives in Hong Kong, the Inland Revenue Ordinance, Cap. 112 was amended in 2014 to provide tax concession for captive insurers to enjoy a 50 per cent reduction in the profits tax on their insurance business of offshore risks. With the passage of the relevant amendment bill by the LegCo in July 2018, the 50 per cent profits tax concession has now been extended to cover both offshore and on-shore risks. The tax concession provides further impetus for groups or enterprises to consider setting up captive insurers in Hong Kong to underwrite their own risks. The development of captive insurance would reinforce Hong Kong's status as a regional insurance hub, while making Hong Kong's risk management services more diversified. According to a report released by the Hong Kong Financial Services Development Council in 2017, it is a realistic goal for Hong Kong to become a "world class and leading captive domicile" by 2020.

A two-tiered profits tax rates regime was introduced in April 2018 to reduce the tax rates for the first HKD 2 million of assessable profits to 8.25 percent for corporations and 7.5 percent for unincorporated businesses with effect from the year of assessment 2018/19. Only profits in

[1] In Hong Kong, a captive insurer is defined under the Insurance Ordinance, Cap. 41 as an insurer which carries on general insurance business only and its business (i) does not relate to any liabilities or risks in respect of which persons are required by any Ordinance to be insured; and (ii) is restricted to the insurance and reinsurance of risks of the companies within the same groupings of companies to which the captive insurer belongs.

excess of the first HKD 2 million are subject to the maximum rate. The new regime would greatly benefit small and medium enterprises. Hong Kong's simple, low and predictable tax regime continues to attract investors to do business and expatriates to pursue their careers here.

Pursuant to the delegated authority conferred on the HKSAR by BL 151, HKSAR may on its own, using the name "Hong Kong, China", maintain and develop relations and conclude and implement agreements with foreign states and regions and relevant international organizations in the appropriate fields, including the economic, trade, financial and monetary, shipping, communications, tourism, cultural and sports fields. Hong Kong has signed comprehensive avoidance of double taxation agreements/ arrangements ("CDTAs") with various jurisdictions. These CDTAs aim at preventing double taxation and fiscal evasion, and fostering closer cooperation between Hong Kong and other jurisdictions. In March 2018, the HKSARG signed a CDTA with India, the third largest economy in Asia. The CDTA will attract more Indian enterprises to use Hong Kong as their base for overseas investments and elevate trade relations between the two economies to a new level. So far, we have signed CDTAs with 40 jurisdictions.

Hong Kong's independent taxation system under BL 108, its low tax regime and the CDTAs enable Hong Kong to grow in many different directions—to be a city of opportunities, development and success.

Hong Kong's free trade

Another driving force behind Hong Kong's success as the world's freest economy is our free trade policy. Pursuant to BL 114 and 115, Hong Kong is a free port which pursues a free trade policy and safeguards the free movement of goods, intangible assets and capital. As a founding member of the World Trade Organization ("WTO"), Hong Kong supports a free, open and stable multilateral trading system and actively participates in WTO's activities.

After 1 July 1997, the HKSAR has continued its separate membership in WTO, under the name "Hong Kong, China". Hong Kong, China adheres to the rules of the WTO and is against any restrictive trade measures that are inconsistent with WTO Agreements. Riding on its high degree of autonomy under BL 114 and BL 115, as well as its status being a separate customs territory under BL 116 and complemented by BL 151, the HKSAR has signed a number of Free Trade Agreements ("FTAs") with its trading partners. In 2017, Hong Kong signed FTAs with the Macao Special Administrative Region and the Association of Southeast Asian Nations respectively. More recently, Hong Kong signed an FTA with Georgia in June 2018, being our seventh FTA. The Basic Law has provided a strong backing for Hong Kong to expand its network of FTAs over the years.

Customs and immigration

The HKSAR shall be a separate customs territory pursuant to BL 116(1). The Customs and Excise Department ("C&ED") safeguards Hong Kong's status in this regard and carries out its functions in accordance with the Customs and Excise Service Ordinance, Cap. 342.

As a gate-keeper guarding the HKSAR's boundary against smuggling activities, the C&ED plays a key role in maintaining the city's status as an international port and trade centre. On boundary enforcement, Hong Kong has a renowned import and export regulatory regime with stringent control over passengers and cargoes entering and leaving Hong Kong including those to and from Mainland China. All cargoes, mails and parcels, passengers and carriers entering or leaving Hong Kong by air, sea or land routes are subject to customs inspection and clearance.

Under BL 154(1), the CPG shall authorize HKSARG to issue HKSAR passports to all Chinese citizens who hold HKSAR permanent identity cards. Under the same article, the HKSARG is also authorized to issue other travel documents. In addition, CPG has given formal authorization for the HKSARG to negotiate visa abolition agreements and arrangements with other foreign countries pursuant to BL 155. Many countries/territories which have granted visa-free access to HKSAR passport holders have received reciprocal treatment by HKSARG to their passport holders. Visitors from over 170 countries/territories can enjoy visa-free entries to Hong Kong and stay for between 7 and 180 days.

Legal infrastructure and professional services

Under BL 118, the HKSARG shall provide an economic and legal environment for encouraging investments and the development of new industry. As an international business and financial centre, the HKSARG has endeavoured to provide a favourable legal infrastructure for businesses large and small. For instance, the HKSARG launched a comprehensive exercise to rewrite the Companies Ordinance, Cap. 32 in mid-2006 with the aim of modernizing Hong Kong's company law and further enhancing Hong Kong's status as a major international business and financial centre. Following five rounds of public consultations and numerous discussions in a series of public forums and seminars, the Companies Bill was introduced into the LegCo in January 2011. The new Companies Ordinance, Cap. 622, together with 12 pieces of subsidiary legislation made under it, provides a modernized legal framework for the incorporation and operation of companies in Hong Kong. It aims at enhancing corporate governance, ensuring better regulation, facilitating business and modernizing the law. Cap. 622 commenced operation on 3 March 2014, modernizing our company law by making the directors more accountable and strengthening the protection of shareholders. It streamlines procedures, reduces compliance costs and facilitates small and medium enterprises to prepare simplified financial and directors' reports.

In addition to legal infrastructure, businesses in Hong Kong are privileged to have the support of a vibrant professional services sector. Blessed with BL 142 which allows the HKSAR to regulate various professions on its own, Hong Kong offers

a host of professional services including legal, accounting, human resources, consultancy, training and more to facilitate business operation and to safeguard the interests of different market participants. In particular, Hong Kong's business sector is supported by a strong team of legal professionals, who possess a wealth of expertise in different areas such as banking and finance, maritime, construction, intellectual property and information technology. As of September 2018 there are around 1,500 practising barristers and 9,700 practising solicitors in Hong Kong. Indeed, many world-renowned international law firms choose to have their offices in Hong Kong. Legal professionals from outside Hong Kong bring with them additional experience in the areas of transnational civil, commercial and compliance law, complementing the existing talent pool of local legal professionals. They bring in an international perspective and experience in cross-border deal making and dispute resolution.

Importance of the Basic Law for the HKSAR's status as an international financial centre

Our own currency

Under BL 111(1), the Hong Kong dollar, as the legal tender in the HKSAR, shall continue to circulate. Pursuant to BL 111(2), the HKSARG is vested with the authority to issue Hong Kong currency. Except the HKD 10 note issued by the HKSARG, banknotes of other denominations are issued by three commercial note-issuing banks authorized by the HKSARG. In accordance with BL 111(2), the Hong Kong dollar banknotes are fully backed by US dollars held by the Exchange Fund. When the note-issuing banks issue banknotes, they have to submit an equivalent amount of US dollars at the rate of HKD 7.80 to one US dollar to the Hong Kong Monetary Authority for the account of the Exchange Fund in exchange for Certificates of Indebtedness. This linked exchange rate system, established since 1983, has ensured the stability of Hong Kong dollar even at times of turmoil. A stable currency safeguards investment and is fundamental to Hong Kong's monetary system, and supports Hong Kong's role as a leading international financial centre. The Hong Kong dollar remains one of the most traded currencies in the world.

Monetary and financial systems

One important element to Hong Kong's status as an international finance centre is the solid infrastructure that facilitates and also regulates the monetary and financial services. Pursuant to BL 110(2), the HKSARG shall, on its own, formulate monetary and financial policies, safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with law. The Hong Kong Monetary Authority is the government authority in Hong Kong responsible for maintaining monetary and banking stability. On the other hand, the Securities and Futures Commission is an independent statutory body to regulate Hong Kong's securities and futures markets.

BL 109 gives the HKSARG a mandate to maintain a transparent and robust regulatory regime for the financial sector commensurate with the city's status as an international financial centre. Hong Kong has actively participated in the Financial Stability Board ("FSB")[2] and other international standard-setting bodies such as the Basel Committee on Banking Supervision, International Organization of Securities Commissions and International Association of Insurance Supervisors, and has been a key player contributing to the development of global financial regulatory reform on various fronts.

A recent example of new legislation to strengthen our status as an international financial centre is the Financial Institutions (Resolution) Ordinance, Cap. 628 which became effective in July 2017, and establishes the legal basis for the resolution regime in Hong Kong. The regime enables regulatory authorities to ensure that failure of financial institutions can be managed in an orderly manner without significant adverse consequences for the financial system and to ensure that the costs of failure are borne by the failing institutions' shareholders and creditors instead of taxpayers. In FSB's recent report published in February 2018, which reviewed Hong Kong's resolution regime, the FSB found that Hong Kong now has legal powers and safeguards related to resolution that are consistent with those required under the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions. The resolution regime applies to a wide range of financial institutions, making Hong Kong one of the few FSB jurisdictions with a fully cross-sectoral resolution regime.

Free flow of capital

Pursuant to BL 112(2), the HKSARG must safeguard the free flow of capital within, into and out of Hong Kong. According to the Bank for International Settlements, Hong Kong was the second largest foreign exchange market in Asia and the fourth largest market in the world in 2016, with the net daily average turnover reaching USD 437 billion.

With the blessing of BL 111 and 112, and under "one country, two systems", Hong Kong emerges as the largest offshore renminbi market in the world. Hong Kong was the first offshore market to launch renminbi business back in 2004. Along the expanding use of renminbi in global trade and investment activities over the years, Hong Kong has developed into the global offshore renminbi business hub with the deepest renminbi market

2 The Financial Stability Board was established in April 2009. Its members include the G20 countries, plus four financial centres – Hong Kong, Singapore, Spain and Switzerland. The Financial Stability Board coordinates at the international level the work of national financial authorities and international standard-setting bodies and promotes the reform of international financial regulations.

outside Mainland China. Banks and other financial institutions in Hong Kong offer a full range of renminbi services to meet the needs of different businesses and investors. With its strengths as an international financial centre and its close ties with Mainland China, Hong Kong has become the global hub for renminbi trade and banking services, financing, asset management, as well as clearing and settlement. The highly efficient market infrastructure in Hong Kong, including the Renminbi Real Time Gross Settlement system, is playing a critical role in facilitating market participants from all over the world to handle renminbi transactions both with Mainland China and among the offshore markets. In 2017, Hong Kong shares over 70 percent of cross-border renminbi payments all over the world.

Conclusion

Under the auspices of the Basic Law, the HKSAR is a strategic gateway to the Mainland and Asian markets. The sheer number of offices established by multinational companies in Hong Kong speaks to the popularity of the city. As of June 2018, there were 1,530 regional headquarters and 2,425 regional offices in Hong Kong. Amongst these regional headquarters, 1,162 of them were responsible for the business or operations in the Mainland in addition to those in Hong Kong, while many of them also responsible for the operations in other economies of Asia.

The Basic Law is the bedrock and the key to the HKSAR's stability and prosperity under the "one country, two systems" principle. Blessed with the unique advantages of both "one country" and "two systems", Hong Kong is the ideal destination for Mainland enterprises looking for growth internationally. Our close ties with the motherland and our high degree of autonomy in taxation, monetary, trade and financial systems make the HKSAR the supreme gateway for both local and foreign businesses to tap into the Mainland China market. Given the unique positon the HKSAR enjoys under the Basic Law, Hong Kong has all the right ingredients to continue to thrive as an international business and financial centre.