



PERMANENT ESTABLISHMENT IN HONG KONG: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

The definition of a Permanent Establishment ("PE") in Hong Kong mirrors the same by the Organization for Economic Co-operation and Development ("OECD"). A PE is generally considered as a fixed place of business through which the business activities of the company are wholly or partly carried on, it could be a branch, a representative office, or other place of business. Therefore, in determining whether the activities of a company constitute a PE, three criteria are to be considered, namely space, time and function. Space refers to a fixed place of business, which may include a house, a site, equipment or facilities, a warehouse, a place for extraction of natural resources, etc., whether owned or rented by the company. Secondly, the term "Permanent Establishment" implies a degree of permanence while disallowing the effect of any temporary suspension of business activities. Moreover, if the fixed place of business only carries out preparatory or auxiliary activities such as solely for the purpose of storage or purchase of goods or collection of information and etc., it would not constitute a PE, considering that the preparatory or auxiliary activities do not by themselves generate profits.

An overseas company would not be deemed to have a PE in Hong Kong if it only carries on business through an independent agent who is merely acting in the ordinary course of its business, unless the agent regularly acts on behalf of that company and has authority to negotiate or conclude contracts in its name.

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

The main difference between a subsidiary and a branch is that a subsidiary is an independent legal entity separate from its owners, as such the parent company would not be liable for the debts of its subsidiary and its legal liability towards the subsidiary would be limited to the amount of any unpaid registered share capital; whilst a branch is not a separate legal entity and the company is accountable for all the debts and liabilities of the branch. On the other hand, a branch can rely on the credit from the company and it would adopt the company's name and carry out the same business activities.

TAX AND ACCOUNTING OBLIGATIONS

In terms of tax and accounting obligations, there is little difference between operating a branch and a subsidiary in Hong Kong. Every person carrying on business in Hong Kong is required to keep sufficient records and books of account of its income and expenditure to enable the assessable profits to be readily ascertained and shall maintain such records for at least 7 years after the completion of the transactions. Failure to do so is an offence which may render the person liable to be fined. A company is required to prepare audited financial statements each year, but it is not mandatory for a branch or a dormant company to do so.

The primary taxes levied in Hong Kong are profits tax, salaries tax and property tax. There is no capital gains tax or valued-added tax in Hong Kong. Profits tax is levied only on "revenue profits" and not income of a capital nature; its tax rate is 16.5% for corporations and 15% for individuals and unincorporated business, including branches. Loss incurred in the production of assessable profits may be carried forward indefinitely and could be offset against the assessable profits in the subsequent years. Unless specifically exempted, a person carrying on business in Hong Kong is required to file an annual Profits Tax Return to the Inland Revenue Department for final tax and provisional tax purposes together with the audited financial statements and a profits tax computation in support.



REGISTRATION FORMALITIES

Under the one-stop company and business registration service, any person who applies for incorporation of a local limited company, such as a subsidiary company, or register of a non-Hong Kong company will be deemed to have made a simultaneous application for business registration. Upon approval of an application for company incorporation, the Companies Registry will issue the Certificate of Incorporation and the Business Registration Certificate in one go. The business registration certificate should be renewed annually by settling the payment on the renew demand note issued by the Business Registration Office. The valid business registration certificate must be displayed in a conspicuous place at the address where the business is carried on.

Apart from business registration, a Hong Kong company is also required to deliver an annual return to the Companies Registry within 42 days after the anniversary of the date of the company's incorporation every year. The annual return contains the particulars of the company such as its shareholders, directors, secretary, the registered office address, etc. The annual return should be submitted even if the information contained in the last return has not changed.

A company should also ensure that the information recorded at the Companies Registry is up-to-date by notifying them any changes relating to the company particulars as mentioned above within the prescribed time period.

STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

Like a subsidiary company, a branch office must also be registered with the Companies Registry. However, the one-stop company and business registration service is not applicable to the registration of a branch office; therefore, the application for branch registration shall be lodged directly with the Business Registration Office of the Inland Revenue Department in advance. Similarly, a branch office must also comply with the compliance requirements like renewal of the branch registration, filing annual returns, notify changes of company particulars, filing profits tax returns and etc.

Comparing with a subsidiary company, a branch office's ongoing maintenance cost is lower. For instance, a separate audit of a branch office is not mandatory in Hong Kong. Upon cessation of the Hong Kong branch, the capital can be easily remitted back to the parent company. On the other hand, the documents and information of the parent company are required for the registration of a Hong Kong branch. A Hong Kong branch office must appoint at least one Hong Kong resident agent (either an individual or an authorised corporation) to accept legal notice served to the branch.