Tax takes centre stage

The ongoing trade war between the US and China and its implications for the wider region provided food for thought at *ACCA Hong Kong*'s annual tax conference

In his keynote address, Professor Edward Chen shared his insights into how Hong Kong's prosperity and competitiveness under the China-US trade tension can be maintained.

The escalating US-China trade war has cast a shadow over Hong Kong's economic outlook and underscored the need to consider how to safeguard the city's competitiveness. This was the focus of attention at ACCA Hong Kong's annual tax conference in late April.

Just after the conference, the US hiked tariffs on US$200bn of Chinese goods from 10% to 25% and suggested that it would extend this to another US$300bn of goods. China responded by raising tariffs on US$60bn worth of US goods. Despite widespread expectations, and to the surprise of virtually everyone, no deal has yet been reached. Meanwhile, Hong Kong, where much of the economy depends on trade, is stuck between the two economic powerhouses.

ACCA Hong Kong's conference brought together experts and business leaders to discuss how to safeguard the city's competitiveness under economic and political turbulence. In her welcome address, *ACCA Hong Kong* chairwoman Natalie Chan said that Hong Kong, as 'a major international financial hub and an open economy', is susceptible to external changes like Brexit and the US-China trade war.

'In the light of these challenges, we need to keep an eye on any new tax or regulatory changes,' she said.

Power play

Contrary to appearances, the US-China trade war may not be about trade at all but about the geopolitical position between two big powers, said Professor Edward Chen GBS, JP, Distinguished Fellow of the Hong Kong Institute for Humanities and Social Sciences at the University of Hong Kong, in his keynote speech on maintaining Hong Kong's prosperity and competitiveness under the trade tensions.

'China's Belt and Road initiative that aims to link up over 60 countries has led to the US trying to suppress its rise,' said Chen, adding that the trade imbalance that the US claims and its relevance may have been exaggerated.

'China's trade surplus only accounts for 1.5% of its GDP, or US$168bn, when those of Japan and Germany are 4% and 8% of their GDP respectively,' he said.

'The direct impact of the trade war on Hong Kong is small. US–China entrepot trade via Hong Kong in 2017 was just 9% of Hong Kong's total export and import trade,' he added.

But the indirect impacts could include shrinking of world trade and financial market instability as well as business, consumer and investment pessimism. Any slowing down of the Chinese economy will reduce demand for Hong Kong's modern services, he warned.

Chen said that there are three things Hong Kong can do to stay competitive. First, the Special Administrative Region, which touts itself as a very open economy, should deepen and widen economic cooperation as it is too small to rely on itself to defend against economic recession and instability. Second, Hong Kong should look more at emerging markets such as South Asia, ASEAN and Africa. Third, it should put in place supply-side policies to foster a tech ecosystem and encourage creativity to complement innovation and tech development.

Watch and prepare

Although the direct impacts of the trade tensions on Hong Kong may be limited, the business sector is watching out for any relevant implications.

Kitty Fung, executive director and group CFO at food retailer and vehicles importer Dah Chong Hong Holdings, advised her peers to remain cautious in procurement and to diversify their portfolio.

'The appetite for consumption is weaker and consumers are more careful when buying luxury items, so we are more cautious in procuring these items,' she said. 'Our company has also added more economic-resistant goods to our portfolio to resist an uncertain economic outlook.'

Fung added that companies should be creative in finding opportunities in a bearish environment, such as enhancing marketing and services to stimulate consumption.

Derek Lee, a partner at PwC Worldtrade Management Services China and Hong Kong, suggested companies engaging in crossborder transactions of controlled technology or goods should be more cautious to avoid violation of US export or sanction controls, which is an important area. However, companies appear to be ill-prepared in this regard.

He pointed out that violations may lead to significant exposures to companies, even to potential closure of markets. Hardware, software and technology relating to the design, development and production of controlled goods could be subject to these controls, and re-exporting such goods or technologies could also be restricted.

'It is becoming more important for companies to ensure compliance in this area,' Lee said.

Many believe that US President Donald Trump is a wild card, so the geopolitical

A lively panel discussion between (from left) Stephen Wong, Derek Lee, Kitty Fung and Ellis Cheng, moderated by Dr Danny Po FCCA, Deloitte's China, Hong Kong and International M&A tax adviser and co-chairman of *ACCA Hong Kong*'s tax sub-committee, considered the implications of the China-US trade tension for Hong Kong's businesses in the future.

Natalie Chan (sixth right) with the speakers and moderators who took part in *ACCA Hong Kong*'s Annual Tax Conference.

landscape and US-China relations could see drastic changes that are difficult to predict, said Stephen Wong, adjunct associate professor at Hong Kong University SPACE's Institute for China Business.

'There is not enough strategic thinking on Hong Kong's position between the US and China in the long term,' Wong said. 'The stricter enforcement of the export control law could also hinder Hong Kong to transform from a small open economy to part of a bigger open economy of the Greater Bay Area.'

He also advised companies to bear in mind the overall bearish market sentiment brought by the strained trade tensions between the two big economies when making business decisions.

Meanwhile, some business elites do not see the trade dispute as a war between the US and China. Ellis Cheng FCCA, CFO at Kerry Logistics Network, simply called it 'trade diversion'. In today's highly globalised world, a product can be assembled in one country after collecting parts manufactured elsewhere. Therefore, the tariffs on Chinese goods may not have a huge impact on the global trade.

He also noted another phenomenon that has emerged in recent years.

'Factories are being relocated to South-East Asia and Taiwan,' he said. 'The move was happening before the trade war as the manufacturing costs in China are rising. The trade war just acts as a catalyst of this process.'

BVI gets tough

But the tax conference was about more than the impact of the trade war. Another point of focus was the new Economic Substance (Companies and Limited Partnership) Act 2018 enacted in the tax haven the British Virgin Islands (BVI) on 1 January.

For Hong Kong businesses, the new act is important because BVI legal entities carrying out headquarters, holding, intellectual property and distribution and service businesses, among others, will now need to demonstrate adequate economic substance in the BVI. This concept of economic substance includes an adequate number of qualified employees physically present in the BVI, adequate expenditures in the country, physical offices for core income-generating activities, and more.

'Corporates should look at their organisational and operational structure to determine if they should keep the already established BVI legal entities and look into the purpose of establishing them, if they are still needed for temporary holding structure or M&A activities,' said Wenna Choi FCCA, Asia-Pacific tax director at global automotive seating supplier Adient.

Kenny Wei FCCA, partner in international tax services – transfer pricing at EY, also warned companies to look ahead to any more requirements that may be on the horizon.

'Now there's a new requirement on substances. What if later there's another one on risk levels that requires companies to have adequate capital to assume the risk and decision-makers to take up this responsibility?' Wei asked. 'In this case, if a company still holds an entity in the BVI, it will need to beef up its substances.'

Despite the foreseeable rising costs of having a holding company in the BVI and offshore jurisdictions in general, Donald Tsang FCCA, executive director and head of corporate services at Intertrust Hong Kong, said that businesses can still benefit from the business-friendly legal systems of these jurisdictions.

'BVI is still a cost-effective jurisdiction – for example, when it comes to transfer of shares in M&A activities,' Tsang said. 'It is advisable to take a comprehensive evaluation relevant to the organisation's business purpose and objectives when determining in which jurisdiction to set up the entity.' AB

Elise Mak, journalist