



**DEZAN SHIRA & ASSOCIATES**

Your Partner for Growth in Asia

# Hong Kong's National Security Law and its Impact on Businesses

August 26, 2020





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# The National Security Law



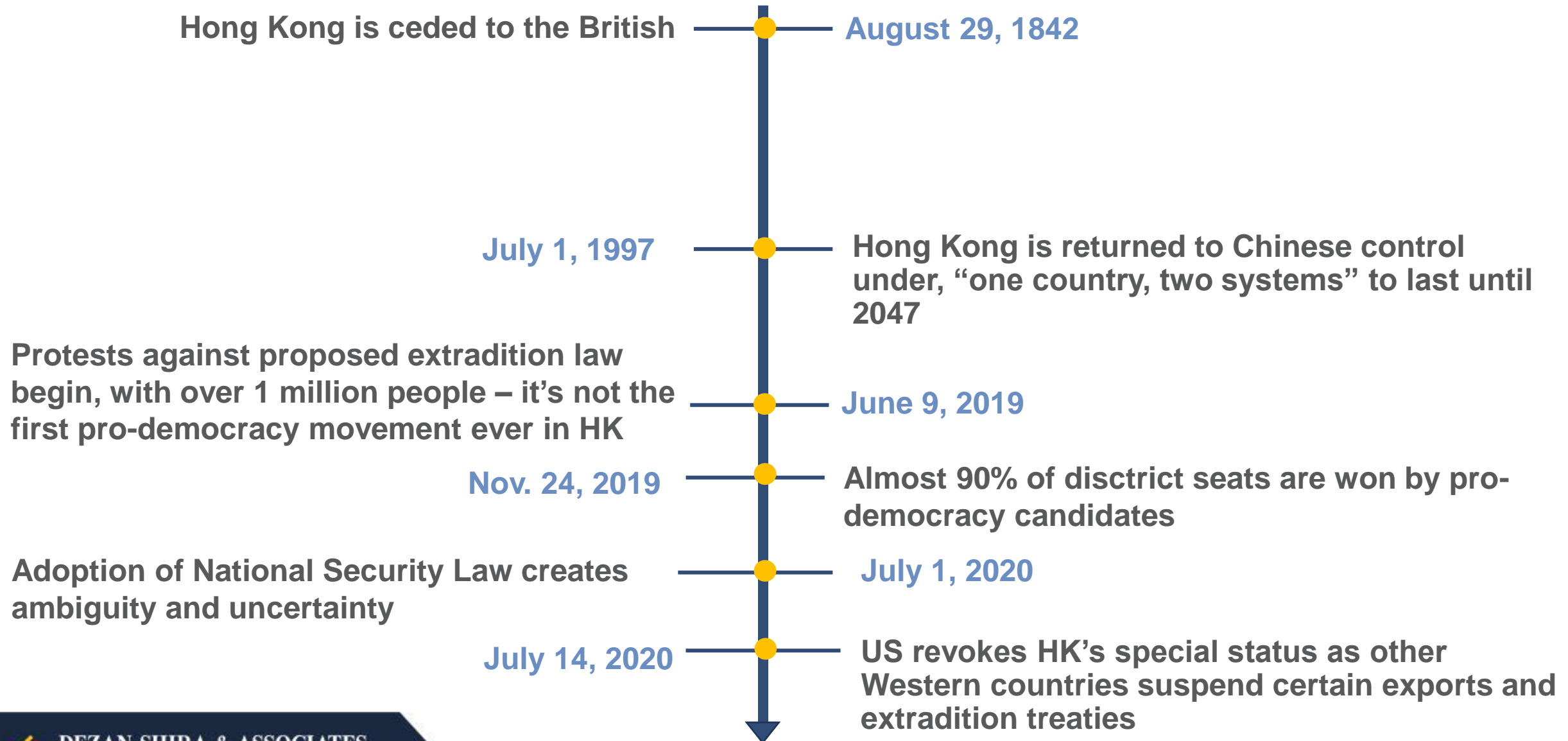
# The Financial Hub of Asia


Hong Kong attained status due to:

- Rule of law under independent common law legal system
- Independent judiciary
- Relatively low taxes
- Lack of capital controls
- Concentration of financial and legal service providers
- International openness
- Access to mainland China
- Proximity to other Asian countries



# Key Dates Leading up to the National Security Law





"I am confident that after the implementation of the national security law, the social unrest which has troubled Hong Kong people for nearly a year will be eased and stability will be restored, thereby enabling Hong Kong to start anew, focus on economic development and improve people's livelihood."

- Carrie Lam, Chief Executive of Hong Kong

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# What's in the National Security Law? - Highlights

## Chapter III

Part 1:  
**Succession**

Part 2:  
**Subversion**

Part 3:  
**Terrorist  
Activities**

Part 4: Collusion  
with a **Foreign  
Government**

Art. 38: This law applies to offences committed by a person from **outside** the region who **is not** a permanent resident of the region

## Chapter V

Art. 54: Take necessary measures to strengthen the management of and services for organs of **foreign countries** and international organizations in the Region, as well as **non-governmental organizations** and **news agencies**

- The Law also grants the right for the Chinese central government to create its own law enforcement presence, "Office for Safeguarding National Security", in Hong Kong which will have authority to investigate national security cases that are, "complex", "serious" or "difficult".

# What are the Penalties for Breaking the Law?

**Short-term detention to life imprisonment**, depending on the perpetrators' degree of participation in the prohibited acts and the seriousness of the offence.

**Deportation of non-permanent residents** of Hong Kong, which could be imposed as a sole or additional punishment, even when no prosecution occurs

**If a company** or an organization, consequences include a criminal fine, suspension of operation, and revocation of business license or permit

- Any proceeds related to the offense will be seized and confiscated



# Conflicting Viewpoints

“The new national security law...lies in direct conflict with its [China’s] international obligations under the principles of the legally binding, UN-registered Sino-British Joint Declaration”  
- Joint Statement



"The Chinese government is unwaveringly determined to safeguard the interests of national sovereignty, security and development, to implement the 'one country, two systems' policy, and to oppose any external force interfering in Hong Kong affairs."  
-Zhao Lijian, Foreign Min. Spokesperson



# US response

May 28, US releases joint statement of concern with Canada, the UK, and Australia



May 27 – Mike Pompeo notifies US Congress that White House no longer regards Hong Kong as autonomous from mainland China



July 14, Trump issues executive order ending Hong Kong's Special Status (July 14) and signs law to sanction individuals and banks seen to be eroding HK's autonomy



August 7, US sanctions Carrie Lam, Chief Executive of Hong Kong and 11 others  
August 10, the Ministry of Foreign Affairs sanctions 11 American officials and other individuals



August 11, US announces goods made in HK will have to be labeled "Made in China"  
August 20, US announces will end tax agreement preventing double taxation on shipping

**Its Business Impact**



## Bilateral Trade Relations

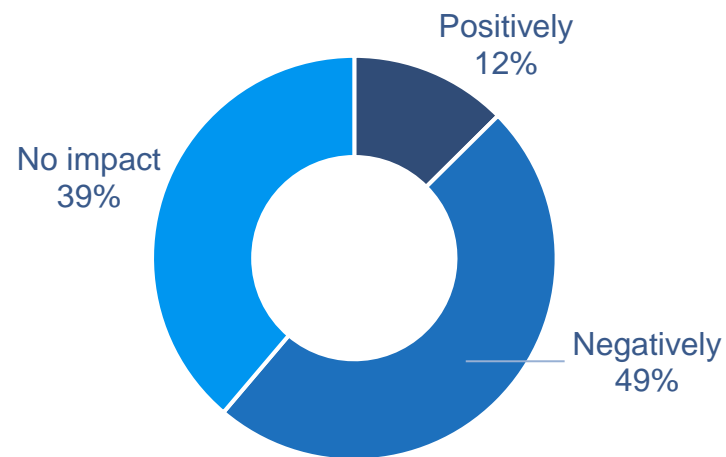
- The U.S. had a trade surplus with Hong Kong in 2019 - USD\$26 billion
- The US was Hong Kong's 2nd largest trading partner in 2018
- In 2018:
  - There were **290** major US companies with **regional headquarters** in Hong Kong;
  - **434** with **regional offices**;
  - **627 local offices** with parent companies in the US
- End of 2018, there were nearly 21,000 US nationals residing in Hong Kong
- As of 2018, the stock of U.S. foreign direct investment in Hong Kong stood at \$82.5 billion, an increase of \$1.2 billion that year, according to U.S. Commerce Department data.
- Hong Kong's investment in the United States rose \$3.5 billion in 2018 to \$16.9 billion.

# On-the-ground Sentiment

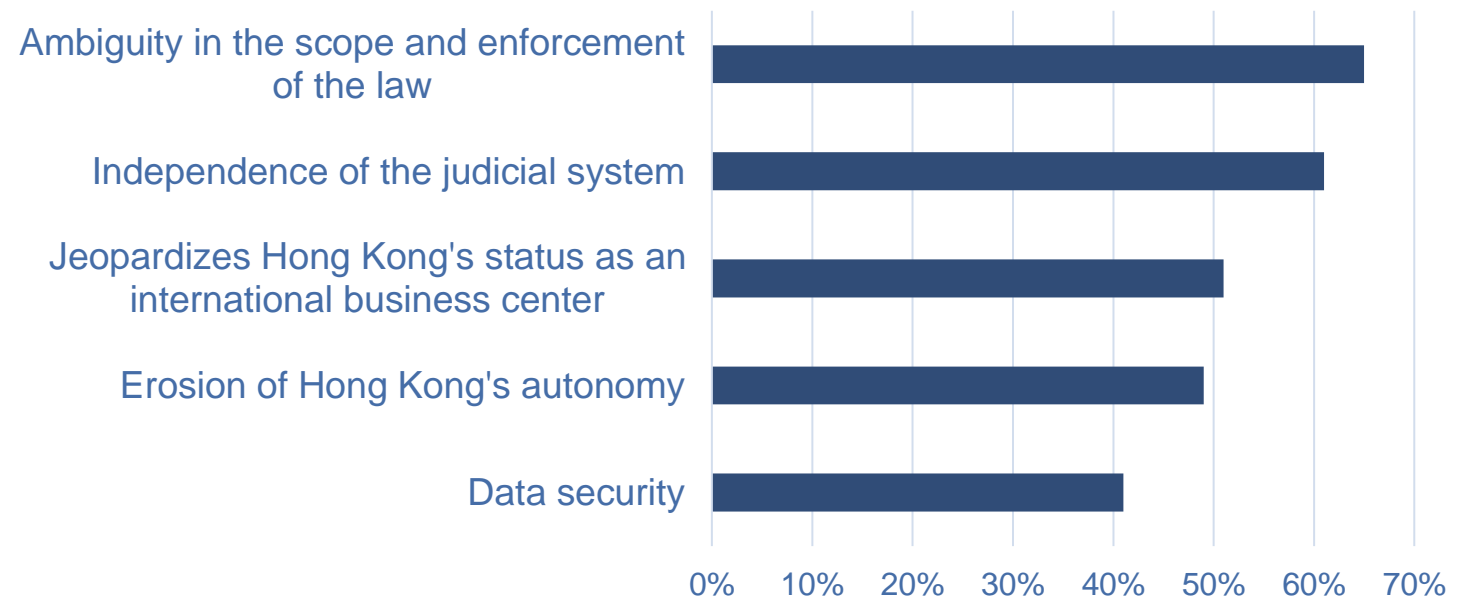
## Results from an AmCham Hong Kong survey:

- **76%** of respondents said they were **somewhat to extremely concerned** about the National Security Law
  - **68%** were **more concerned** than they were one month ago
- **54%** are **pessimistic** in the medium-long term, while **46%** are **optimistic** in medium-long run

## How will your business be impacted by the NSL?



## Top 5 Major Concerns



# Ways Businesses will be Impacted

- Companies will have to pay attention to funds or property received, provided or processed to ensure they aren't being used in activities that may be perceived as harming national security
  - This means companies will need to do due diligence and monitor business partners to verify dealings are lawful
- In accordance with Article 2, businesses will need to exercise caution in communication with general public to avoid suggesting Hong Kong is not a part of the PRC
- **The Law has a global reach**, applying to offences committed outside Hong Kong by Hong Kong permanent residents, companies/organizations incorporated in Hong Kong, or non-Hong Kong permanent residents
  - Businesses in Hong Kong with operations outside must raise awareness with foreign employees to comply with the requirements under the National Security Law
  - Might be hard to do in age of social media
- It may be harder to attract and retain top tier talent in Hong Kong
- Businesses may have to begin to assess the political consequences or potential for offence, prior to taking action much like many companies have been doing in mainland China for years

## Ways Businesses will be Impacted Cont.

- Businesses and individuals will have to comply with legitimate law enforcement requests. Law enforcement agencies will be able to:
  - Enter and search places without a warrant and inspect,
  - Seize anything believed to be evidence of an offence harming national security
  - Freeze, restrain and confiscate property relating to such an offense
  - Remove messages harming national security and compel platform, hosting, and network service providers to assist
- *Ex: someone who knowingly contravenes a notice issued by the Secretary for Security to freeze offence-related property will be liable and may bear a fine and/or imprisonment*
- Businesses required to comply with US sanctions must balance US and Hong Kong compliance – practically speaking the scope of sanctions are small, but could be a major compliance headache
- The most optimistic view holds that if the law is solely used to quell the mass protests then Hong Kong could be a better place to do business
  - Industries impacted by protests may benefit
  - How will culture of city change?

# Impact of the Revoked Special Status

- The United States revocation of preferential treatment for Hong Kong has several implications:
  - Hong Kong passport holders will be treated as PRC passport holders (Not much discernable difference in how they're treated currently)
  - “Dual-use” items will be restricted, same as the PRC
  - Exported goods from Hong Kong are to be marked as from the PRC, but Hong Kong origination will still be recognized (if the goods are truly Hong Kong originating)
  - Hong Kong’s special treatment under the Arms Export Control Act has been suspended

## What this means for trade:

- US imports - the same tariffs being applied to Hong Kong goods **will likely have little impact**
  - Services make up 92% of Hong Kong’s GDP
  - U.S. accounted for only about 8% for overseas shipments in 2019, 77% of those were re-exports from China (i.e. only 1.84% of exports from Hong Kong could potentially be impacted)
- US exports – **little to no impact...YET**
  - Neither Hong Kong nor China have changed customs treatment of US originating goods – **YET**
  - This whole saga should be seen as one front among many in US-China trade war – bigger question is how will it affect US companies in China
- Affected goods falling under export controls amount to \$400-500 million a year, mainly including telecoms and information security products and electronics



## How the law has been interpreted so far

- Hong Kong media tycoon, Jimmy Lai, was the highest profile to be arrested August 10th. He was frequent critic of the government
  - charges of collusion with a foreign country/external elements (read United States) to endanger national security, conspiracy to defraud
  - 200 police raided his newspaper, Apple Daily's, offices
  - 10 other individuals were arrested including employees of the media publication
  - ““HARDCORE TROUBLEMAKER”” in Global Times-speak
- Many involved in the protests in 2019 are scrubbing their digital presence
- 10 people were arrested July 1st during a protest marking the handover of Hong Kong to China in 1997 for carrying separatist stickers and pro-independence flags
- Educational institutions have been told to review curriculum
- The New York Times and TikTok are leaving Hong Kong (read what you will from the latter)
- Facebook, Google, LinkedIn, Zoom, Twitter and Telegram are pausing data-processing requests from Hong Kong as they assess impact of the law

**The affect on SMEs is likely to be limited, but it's still too soon to tell how the law will be fully implemented as the wording is both expansive, yet ambiguous...**

# Hong Kong's Future



## Big questions remain...

- To what extent will the new law affect businesses who have been operating in Hong Kong?
- Can firms hold true to their Western values when they compete with Mainland popular opinion and government demands?
- Can Hong Kong retain its international appeal?

### Furthermore:

- How does Hong Kong fit into the Greater Bay Area, can it retain its leading position in it? Has it lost that position to Shenzhen already?
- Can Hong Kong remain competitive with Singapore as a regional hub for ASEAN and greater Asia?
- What exactly is Hong Kong's competitive advantage now?



# The Slow Erosion of Hong Kong's Advantages

1. Low taxes
2. **Free flow of information**
3. World-class infrastructure
4. **Traditional gateway to China**
5. **Rule of law**
6. Corruption-free governance
7. Liberal economy
8. Skilled workforce
9. **An international lifestyle**

## **Some of these advantages for Hong Kong may erode over time**

- Like being the traditional gateway to China
- Not necessarily due to the National Security Law

*“If Hong Kong loses... all those things it has treasured, then Hong Kong is not going to be seen as a safe harbor within China and the region for American companies to base their regional headquarters, have most of their capital and large staff, and base their contracts there,” – Scott Kennedy, Senior Advisor at CSIS*

# The Greater Bay Area - Threat or Opportunity?

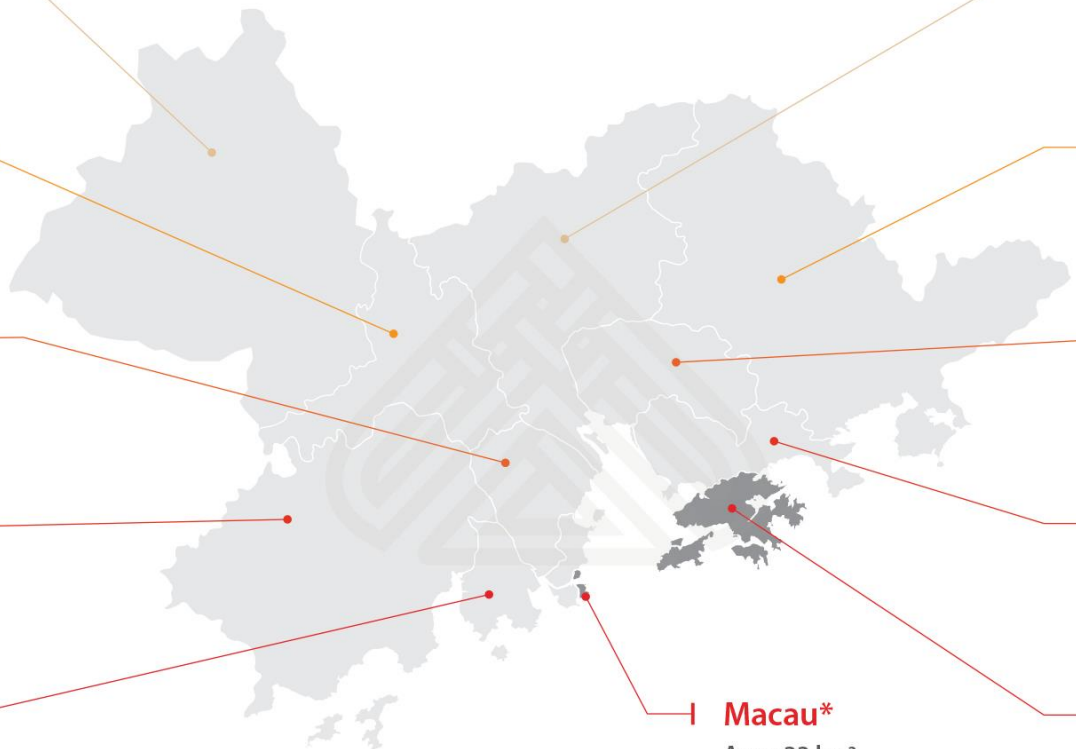
**Zhaoqing**  
 Area: 14,891 km<sup>2</sup>  
 GDP: US\$33.0 B  
 POP: 4.12 M

**Foshan**  
 Area: 3,798 km<sup>2</sup>  
 GDP: US\$149.0 B  
 POP: 7.66 M

**Zhongshan**  
 Area: 1,784 km<sup>2</sup>  
 GDP: US\$54.5 B  
 POP: 3.26 M

**Jiangmen**  
 Area: 9,507 km<sup>2</sup>  
 GDP: US\$43.5 B  
 POP: 4.56 M

**Zhuhai**  
 Area: 1,736 km<sup>2</sup>  
 GDP: US\$43.7 B  
 POP: 1.77 M



**Guangzhou**  
 Area: 7,434 km<sup>2</sup>  
 GDP: US\$342.9 B  
 POP: 14.5 M

**Huizhou**  
 Area: 11,347 km<sup>2</sup>  
 GDP: US\$61.5 B  
 POP: 4.78 M

**Dongguan**  
 Area: 2,460 km<sup>2</sup>  
 GDP: US\$124.2 B  
 POP: 8.34 M

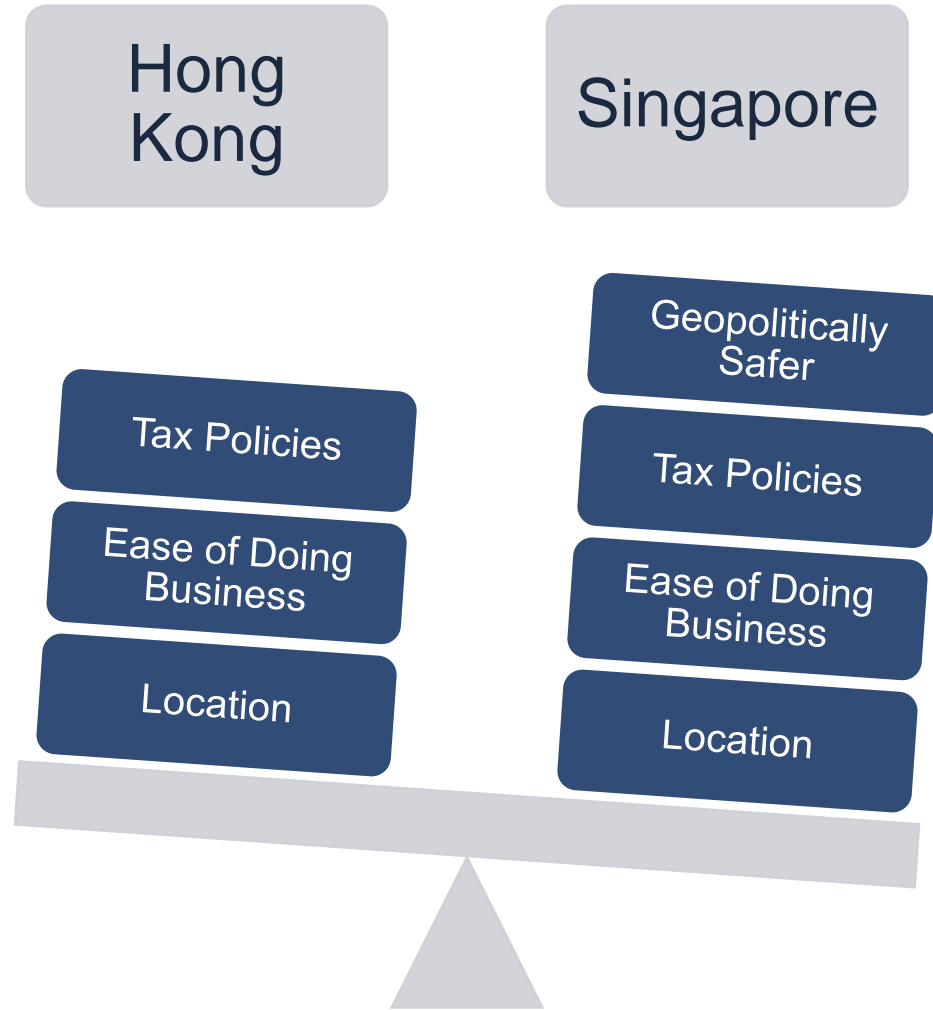
**Shenzhen**  
 Area: 1,997 km<sup>2</sup>  
 GDP: US\$363.3 B  
 POP: 12.53 M

**Macau\***  
 Area: 33 km<sup>2</sup>  
 GDP: US\$54.8 B  
 POP: 0.67 M

**Hong Kong\***  
 Area: 1,107 km<sup>2</sup>  
 GDP: US\$362.0 B  
 POP: 7.45 M

- GBA expected to have GDP of US\$4.62 trillion by 2030
- Law could help integration into GBA – financial services industry may benefit
  - HK exports only 1/3 to the mainland of what it does to the UK
- Some major sectors rely on regulatory separateness:
  - Re-exportation
  - Merchenting
- The GBA plan is to play to each cities' unique strength, for HK, it's finance and foreign investment
- Hong Kong isn't China's only financial powerhouse – Shanghai is being primed as a back-up...or is Hong Kong the back up?

# Singapore – a Competitive Alternative



# The Future of Hong Kong

Results from an AmCham Hong Kong survey:

- **45%** of respondents think the prospect of extradition (2019 issue) will be a **game changer** for Hong Kong as a financial center, primarily because of the **ambiguity**
- **68%** of businesses are going to **wait and see** before determining course of action
- **35%** said their business **will consider moving** assets/capital/operations out of Hong Kong, while **65%** said they **would not**
  
- **Multinationals will have to wait and see**
  - How the National Security Law will be implemented
  - What further measures the US may take
- In the short-term, Hong Kong is likely to continue to appeal to foreign investors
- In the long-run, we might see Hong Kong lose its competitiveness to other destinations
  
- But in the meantime...
  - Stay agile
  - Stay up-to-date
  - Educate employees who work in Hong Kong or may travel on business there or to mainland China

# Singapore as an Alternative





# Singapore's Advantage

- Another British colony, developed like Hong Kong:
  - International openness
  - Rule of law under an independent common law legal system
  - With low levels of corruption
  - With low taxes, and high financial freedom.
- Singapore is a strong competitor with Hong Kong in numerous ways

Singapore:

- ✓ Has strong institutions
- ✓ Is strategically located
- ✓ Offers many tax incentives
- ✓ Enjoys tax agreements with many partners
- ✓ Has a skilled, English savvy workforce

4,200 regional  
HQs in  
Singapore

**Vs.**

1,541 regional  
HQs in Hong  
Kong

# Economic Overview

## Hong Kong

GDP: 341.4 billion USD (2017)

GDP per capita: 46,193 USD (2017)

GDP growth rate: 3.8% (2017)

FDI Inflow: 104.3 billion USD (2019)

#1 on 2019 Index on Economic Freedom

## Singapore

GDP: 323.9 billion USD (2017)

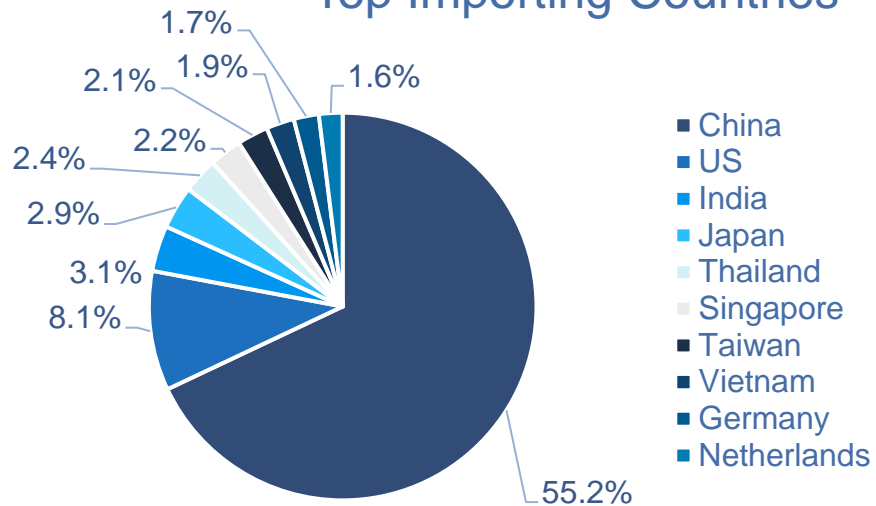
GDP per capita: 57,714 USD (2017)

GDP growth rate: 3.6% (2017)

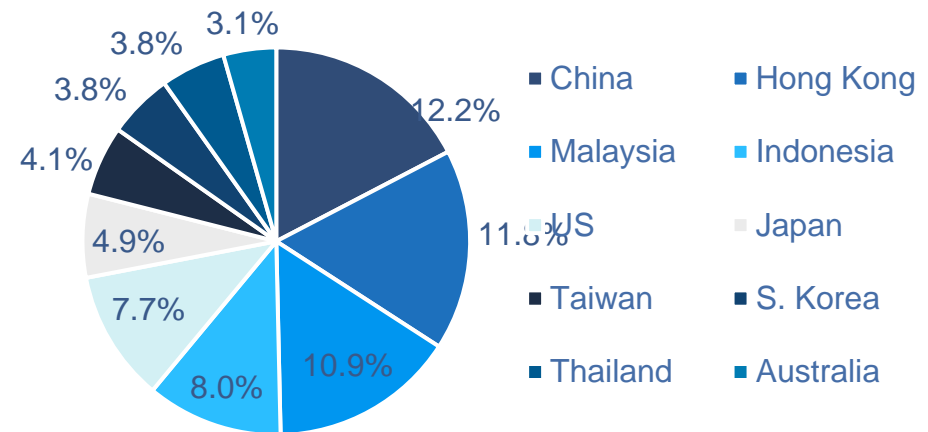
FDI Inflow: 62 billion USD (2019)

#2 on 2019 Index on Economic Freedom

### Top Importing Countries



### Top Importing Countries

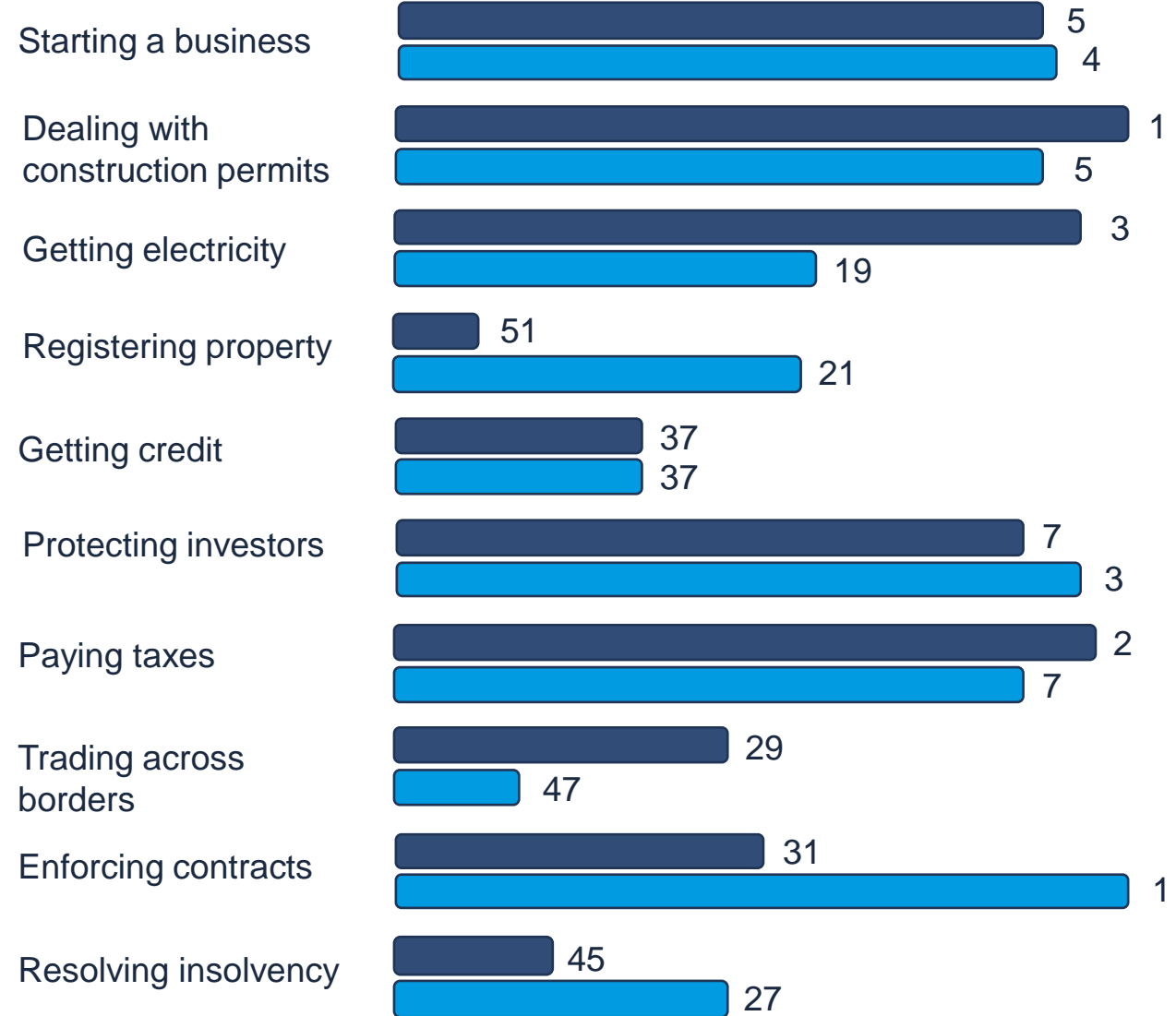


# Ease of Doing Business Ranking - 2020

3rd  
Hong Kong

2nd  
Singapore

■ Hong Kong  
■ Singapore



\*Data compiled from World Bank

# Double Tax Agreements

## Ideal Holding Company Jurisdictions

### Hong Kong

Does not impose withholding tax on dividends leaving jurisdiction

43 - DTAs

- Has concluded with the US:
  - Shipping income treatise
  - Tax information exchange agreement

### Singapore

Does not impose withholding tax on dividends leaving jurisdiction

87 - DTAs

- DTA with US signed but not ratified

# Free Trade Agreements

## Hong Kong – 8 FTAs

### 6 'Bilateral':

- Mainland China
- Australia
- New Zealand
- Chile
- Macao
- Georgia
- Maldives (soon)

### 2 Regional:

- **ASEAN-Hong Kong, China**
- EFTA-Hong Kong, China

## Singapore – 24 FTAs

### 13 Bilateral:

- **United States**
- China
- India
- Japan
- South Korea
- Sri Lanka
- New Zealand
- Australia

- Panama
- Peru
- Costa Rica
- Jordan
- Turkey

### 11 Regional:

- ASEAN-Australia-New Zealand
- ASEAN-China
- **ASEAN-Hong Kong, China**
- ASEAN-India
- ASEAN-Japan
- ASEAN
- TPP
- EFTA-Singapore
- Singapore Eurasian
- GCC-Singapore
- Trans-Pacific Strategic Economic Partnership

# Taxation

	Hong Kong	Singapore
<b>CIT</b>	Flat 16.5% on assessable profits *	Flat 17%
<b>VAT/GST</b>	None	7% **
<b>Tax Jurisdiction</b>	Territorial – taxed only on income sourced or arising from Hong Kong	Territorial - taxed only on income sourced or arising from Singapore
<b>Foreign Exchange Controls</b>	None	None
<b>Capital Gains Tax</b>	0%	0%
<b>Tax on Shareholder Dividends</b>	0%	0%
<b>Tax on Foreign Sourced Income</b>	0%	0% if DTA applies at min., 15% rate
<b>Withholding Tax</b>	Only on non-resident entertainers or sportsmen for performances in HK	Only on non-resident entities sourcing SNG income

\* Hong Kong has 2 tiers for Profit Tax Rates:

- Single tier – Incorporated entities pay 16.5%; unincorporated 15%
- Two-tier profit tax rate regime: Entities pay 8.25% on first HK\$2 million and then 16.5% over

\*\* GST if taxable turnover over US\$738k in 12-month period

# Tax Incentives

## Hong Kong

- Hong Kong does not have any specific tax incentives for foreign investment
- Main tax benefit – offshore funds not subject to profits tax under certain circumstances

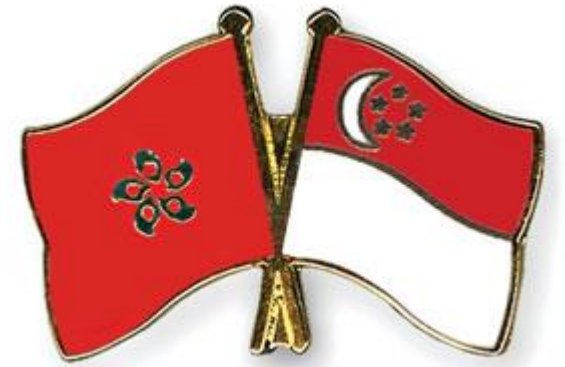


## Singapore

- Many incentives for businesses working in Singapore’s economic goals
  - Applicants must meet rigorous demands
  - Applicants must make substantial economic commitments
- Industry specific tax incentives:
  - Financial services activities
  - Global Trading ➤ Approved ventures
  - Shipping & Maritime ➤ Processing services
  - Tourism ➤ Legal firms
  - Event organization ➤ R&D, innovation & product development
  - E-commerce
  - [Headquarter](#)
- Additional Schemes:
  - SUTE/PTE – Tax exemption scheme
    - 75% for first \$100 SGD up to 3 years
    - 50% for second \$100 SGD
  - EFS – Enterprise Finance Scheme
  - Investment allowance
  - Wage credit scheme
  - Corporate income tax rebates
  - M&A allowance
  - Pioneer tax incentive

# Key Takeaways

- Hong Kong is, and will remain for some time, an extremely important finance, judicial, trading, and administrative center for China, and significant regionally as well
- Singapore today matches Hong Kong step for step on major ease of doing business indicators; linkages with China are strong, and stronger still for SE Asia
- Singapore has a clear plan to remain a regional power which is highly integrated with an emerging giant of a region (ASEAN), maintaining a special relationship with both the US and PRC and a robust FTA network
- HK's future is not so clear, the new security law tells us something about Beijing's view towards the city and its people. Don't expect any kind of reversal in policy...
- In a business sense, the question of what exactly is the point of Hong Kong beyond an urban consumption market will eventually need a clear answer, and it will need to be answered well before 2047. For companies new to the region, or new to setting up regional HQs, I would urge you to ask yourself what will Hong Kong do for me that Singapore cannot...
- Companies with integrated ops in HK should not jump ship immediately, but if SG fulfills the same requirements a long term relocation is worth exploring, especially if ASEAN looks to play role in the regional footprint.







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