

# HONG KONG TAX ALERT

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## US-HK trade, customs and tax - potential impacts

### Summary

Recent announcements made by the US President and US Secretary of State may potentially impact the 'special' status conferred by the United States on Hong Kong for trade, customs and tax purposes. Based on the announcements, the potential impacts are expected to be in the areas of export controls, tariffs, visas and travel. There are also other areas not specifically referenced in the announcements, such as currency, tax treaty relief, tax information exchanges and FATCA. This Alert sets out our analysis as to the impacts in these areas.

Importantly though, the announcements are mainly high level proposals at this stage – there has been no Executive Order issued so the implementation detail is yet to come. The situation is rapidly evolving and therefore should be closely monitored.

On 27 and 29 May 2020, the US Secretary of State and US President respectively made announcements which, upon implementation, would potentially impact on the 'special' status of Hong Kong for trade, customs and tax purposes.

In this alert, we highlight the direct potential impacts on trade, customs and tax associated with these proposed decisions.

### Background

#### Regulatory context

Prior to the handover in 1997, the United States enacted the 'US-HK Policy Act' of 1992. The US-HK Policy Act effectively sought to recognize Hong Kong's status for a number of purposes under US law, including trade (and its membership of the World Trade Organisation); its role as an international financial center; and in areas like aviation and shipping, communications, tourism, culture and sport. The US-HK Policy Act allows the US President to suspend or change (or later rescind) the recognition of Hong Kong's status under US laws through an Executive Order.

In November 2019, the US government enacted the Hong Kong Human Rights and Democracy Act of 2019 ("the HKHR&D Act"). Under the HKHR&D Act, the US Secretary of State is required to certify annually to Congress whether "Hong Kong is sufficiently autonomous to justify special treatment by the United States for bilateral agreements and programs...".

#### US administration announcements

On 27 May 2020, the US Secretary of State, in accordance with the HKHR&D Act, certified that Hong Kong is not 'sufficiently autonomous to justify special treatment by the United States for bilateral agreements and programs...'

On 29 May 2020, the US President made an announcement which foreshadowed the areas in which the United States would seek to alter the special treatment of Hong Kong under US law. In his announcement, the US President said he would:

"...begin the process of eliminating policy exemptions that give Hong Kong different and special treatment. My announcement today will affect the full range of agreements we have with Hong Kong, from our extradition treaty to our export controls on dual use technologies and more, with few exceptions. We will be revising the state department's travel advisory for Hong Kong to reflect the increased danger of surveillance and punishment by the Chinese state security apparatus.

We will take action to revoke Hong Kong's preferential treatment as a separate customs and travel territory from the rest of China. The United States will also take necessary steps to sanction PRC and Hong Kong officials directly or indirectly involved in eroding Hong Kong's autonomy..."

For completeness, the US President did also reference in his speech that he would be getting his Presidential working group to study the differing practices of Chinese companies listed on US financial markets.

### **Trade position between the US and Hong Kong**

Based on data produced by the Hong Kong Trade and Industry Department, it should be noted that:

- The United States was Hong Kong's 2nd largest trading partner as of 2019, accounting for total exports from Hong Kong of just less than USD40 billion or 7.7% of total exports;
- Hong Kong was the United States 21st largest trading partner as of 2018;
- The United States has a substantial trade surplus with Hong Kong. In 2019, the US had a trade surplus of USD26.4 billion over Hong Kong, the single economy with which the US has the highest trade surplus.

### **Potential impacts**

Below we examine the potential trade, customs and tax impacts based on the US President's announcement, together with the earlier certification by the US Secretary of State. It is important to note that these are high level proposals only at this stage – there has been no Executive Order issued so the implementation detail is yet to come.

Based on the announcement by President Trump, it appears the following areas may be directly impacted:

1. **Export controls** – Hong Kong currently applies its own export controls which are recognized by the United States as being separate from that of Mainland China. The list of goods which are subject to export controls is relatively narrow (e.g. munitions and similar items). In practical terms, the main focus around cooperation on export controls between the US and Hong Kong has been around products transiting through Hong Kong, but with a final destination elsewhere. Measures being taken by the US administration may result in additional licensing requirements for certain products coming into Hong Kong, based on the comparable regime in place for Mainland China.

The United States currently also applies export controls to Mainland China of so-called 'dual-use technologies', being technologies which can have both a military and commercial use. The decision by the US administration in relation to Hong Kong's status is likely to result in either additional approval requirements or denial in certain cases in accessing US sensitive technologies which have a dual-use. The precise impact of this proposal is yet to be fully known.

2. **Tariffs** – the United States levies customs duties on the importation of certain products valued at more than USD800. The rate of customs duties varies by product type and by country of origin. The US administration also recently imposed additional tariffs on goods with an origin in Mainland China.

If Hong Kong is no longer regarded by the US as being 'sufficiently autonomous' under US law, then goods with an origin in Hong Kong may become subject to those tariffs on the same basis as those from Mainland China.

Goods would only be regarded as having an origin in Hong Kong where they have been (broadly speaking) manufactured, produced or substantially transformed in Hong Kong. One such test is that 30% or more of the value added to the manufacturing or production process would need to occur in Hong Kong in order for them to originate in Hong Kong. While not yet clear, we anticipate that value adding activities which are carried out in Hong Kong and in Mainland China

may need to be aggregated for the purposes of the 'country of origin' rules applicable on importation to the United States.

Importantly, the fact that goods may transit through Hong Kong (so-called re-exports) or be bought or sold by a Hong Kong company or consumer will not of itself result in them having an origin in Hong Kong and would therefore not be the reason they become subject to any new tariffs.

Based on data produced by the HK Trade & Industry Department, only 1% of exports of goods from Hong Kong consist of products which are manufactured in Hong Kong, and of this amount, less than 8% are exported to the United States. For 2019, the total value of exports to the United States with a Hong Kong origin was under USD500 million. 99% of manufacturers in Hong Kong are SMEs employing less than 100 people, and the products most commonly manufactured in Hong Kong for export consist of jewellery and precious metals, and plastics.

3. **Visas and travel** – Existing visa rules applicable to business visits to the United States currently apply very similar conditions irrespective of whether the traveler is holding a Hong Kong passport or that of Mainland China. The visa waiver scheme for business or tourist trips of up to 90 days do not currently apply to either Hong Kong or Mainland China passport holders. President Trump announced that the travel advisory for US citizens visiting Hong Kong would soon be amended.

### Other areas of 'special status' not referenced

4. **Currency** – the US-HK Policy Act recognizes that the United States should allow the US dollar to be freely exchanged with the Hong Kong dollar. President Trump's announcement makes no reference to this changing.
5. **Tax treaty relief** – President Trump's announcement made no specific reference to tax treaties, and in fact Hong Kong does not currently have a comprehensive tax treaty (except for shipping) in place with the United States. However, there has been a tax treaty in effect between China and the United States since 1987 which does not apply to Hong Kong.

Hong Kong operates a very different taxation system from that of both Mainland China and the United States. In particular, Hong Kong operates a source based taxation system; whereas the United States taxes its citizens on a worldwide basis; and Mainland China taxes its residents on a worldwide basis.

The aim of tax treaties generally is to reduce the burden of double taxation, and because of this it's unlikely the United States would wish to apply the treaty to Hong Kong. It's also necessary for a jurisdiction to opt in to it. It is therefore difficult to foresee developments in this area adversely affecting either Hong Kong businesses or individuals earning income or investing in the United States (and vice versa) compared with the current position.

6. **Tax information exchanges and the Foreign Account Tax Compliance Act (FATCA)** – President Trump's announcement made no specific reference to any change in policy affecting tax information exchanges. Hong Kong does have an information exchange agreement in place with the United States. There is no equivalent information exchange agreement in place between mainland China and the United States. Hong Kong also has a specific agreement in place with the United States governing the implementation of reporting requirements for Hong Kong financial institutions to comply with FATCA. It is unclear whether this agreement would potentially be impacted by the decisions of the US administration. The agreement seeks to support Hong Kong financial institutions compliance with US law.

This is a rapidly evolving situation and therefore further updates to this list will be needed as this progresses.

### Summary

It must be acknowledged that the above does not discount the possibility of further or separate legislative action being taken by the US, nor does it discount the possibility of reciprocal or alternative actions being taken by China, or by other countries. Having said that, these announcements have no impact on the domestic tax system in Hong Kong which will continue to be separate and distinct from that applied in Mainland China.

Some media commentators have referred to the US announcement as being more "symbolic" in nature at this stage, and with any economic consequence more likely to come from the perception it creates in the market rather than the direct impact of the proposals themselves.

Further information on the potential impact of these announcements, please contact your usual KPMG contact.

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