

Manivest International Special Report

Tax and Asset Planning Using Macau Structures

by

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Tax and Asset Planning Using Macau Structures

by

Horace M K Ho, Managing Partner, Horace Ho & Company, CPA

From asset and tax planners' point of view, Macau structures offer opportunities and pitfalls. First of all, Macau is a Civil Law (Code Law) jurisdiction. Legal concepts are different from Common Law Jurisdictions to which our audience accustomed.

There are at least three types of structures¹ that we could use. I would also like to introduce one useful concept (arrangement) permitted under the Commercial Code of Macau.

The three types of structures are:-

- Macau Corporation
- Macau Offshore Institution
- Macau Branch

One useful arrangement is

- "Lease-a-company" or "Rent-a-business"

Firstly, I shall demonstrate the taxation of a Macau structure, excluding an Offshore Institution (which does not attract any tax), comparing to a Hong Kong Corporation, showing the uniqueness of Macau taxation.

Some salience features of the revenue law of Macau

The following Illustration of tax Computation is adopted from "Guide to Investing in Macau"²

I have made some assumptions to the computation and the first column is computation under the current Hong Kong Revenue Law. The balance sheet of the Company consists of the following accounts and balances: Accounts receivable – 2,000,000, provision for bad debt at 5% and Stock 4,500,000.

¹ Macau Structures include : Empresario Individual – Sole properties (EI), unlimited company, mixed liabilities company, two types of LLC, joint stock company, Economic Interest Group (Agrupamento de Interesse Economico AIE) , Joint Ventures and Branches of Foreign Company

² Macau trade and Investment Promotion Institute, Guide to Investing in Macau, 2000, P54

	HK Co	Macau Co
Profit for the year 1999 per account	3,000,000	3,000,000
Add Excess depreciation – Note 8	30,000	30,000
Excessive provision against bad and doubtful debts and obsolete stock – Note 9	325,000	150,000
Non-deductible donations	20,000	20,000
Professional tax paid on behalf of employees	50,000	50,000
	3,425,000	3,250,000
Less: Dividend paid / payable – note 7		2,500,000
Assessable profits for the year	3,425,000	750,000
Less Loss relief brought forward	535,000	535,000
Taxable profit for the year	3,210,000	215,000
Complementary tax at 9.3% on		18,600
20% on 15,000		3,000
		21,600
5% Stamp Duty		1,080
Total Complementary Tax and stamp duty payable	561,750	22,680
Shareholder		
Complementary tax at 15%	0	375,000
Total Tax payable	561,750	397,680

Let us examine this computation by detailing the some salience features of the Revenue Law of Macau for companies. Profits tax in Macau is known as Complementary Tax.

1 The adoption of “Territorial Concept”³

Only income arising in or deriving from Macau is taxable⁴.

2 The different between assessable income in Group A and Group B taxpayers.

Article 19 of the Complementary Tax Law stipulated that assessable profits for Group A taxpayers are profits from operations calculated in accordance with generally accepted accounting principles for the last year of operations, after deduction of costs for the same

³ Complementary Tax – Decree-Law 21/78/M Article 2

⁴ See, for example, Ho Mei Va, Macau Taxation, research paper, The UNESCO Centre of Macao.

year, and after adjustments made according to A20 to A35.

Assessable profits for Group B are established by estimation of its profits and expenses or by indexation method.

3 Assessable Income

Article 20 of the Complementary Tax Law provides that assessable income are those normally appear in the income accounts of a business enterprise, including **dividends, interests, royalties**, ordinary or extra-ordinary, revenue or capital but excluding **rental income**⁵

In respect of interest and royalties, it seems that being taxed in Hong Kong is more favorable. Hong Kong has abolished interest tax and royalties received from Hong Kong is only taxable at 17.5% of 30% of the royalties received⁶.

4 Expenses

Article 21 of the Complementary Tax Law provides that costs and expenses incurred for the production of exempted income is not allowable. Allowable deductions for a business include normal running expenses for the production of chargeable profits. **Certain expenses, if excessive, will be disallowed for example, entertainment and traveling expenses.**

5 Statutory allowable Expenses

- (a) **Other tax and penalty paid**, but not including Complementary Tax Paid.(Art 21(f)),
- (b) Depreciation (Art21(g) – see below
- (c) **Reserve and provisions** (Art 21(h) – see below
- (d) Compensation paid to non-insurable accident (Art 21(i).
- (e) Subject to the approval of the Financial Secretary, **cost of welfare establishments for staff and their family**, that is, nursery, school, canteen and library (Art27).
- (f) Insurance and provident fund expenses, limited to 15% of the staff salary (Art 27)
- (g) **Donation** limited to 0.2% of sales / turnover. (Art28)

6 Disallowable expenses

- (a) Life insurance Art 21(d),
- (b) Overspent entertainment and travelling expenses Art 29(a),

⁵ Ibid, Article 3. Rental income is taxed under Property Tax.

⁶ The 2003-04 Budget Hong Kong SAR, paragraph 85

- (c) Complementary tax Paid Art 29(b),
- (d) Penalty paid due to the contravention of Complementary tax Law Art29(c)
- (e) **Compensation paid to insurable accident but not insured.** Art29(c)

7 Dividends:

Dividends distributed are deductible from the assessable income of the company and will be taxed at the hands of the shareholders Art3(3).

8 Depreciation.

In accordance with Art23, depreciation allowances are provided for in respect of capital expenditure, from 10% to 33%⁷. The rates are similar to rates provided by IRR in Hong Kong but **Straight-line method is adopted.**

The law also provide for the depreciation (amortization) of goodwill, brand name, patent, **pre-operating expenses (33.3%)**, deferred expenses (33.3%) and other intangible assets.

9 Reserves and Provisions.

Macau also allows generous reserves and provisions which are tax deductible (Art 25):

- (a) **Provision for legal costs** can be made according to the progress and expected outcome of the case.
- (b) Technical **Reserve on job-related accident** and work-related diseases to be born by the employer can be made at a rate not more than the insurance premium on an authorised insurer.
- (c) **Provision for Doubtful Debts** on the yearend balances of debtor, limited to 2% of the balance.
- (d) **Provision for devaluation of stock**, equal to 3% of the yearend value of the stock.

The reserves shall be reversed and considered as income for the year when they are no longer needed.

Bad Debts arise due to re-structuring, winding up, liquidation, or insolvent of the debtor can be set off from Provision for Doubtful Debts. The excess can be written off in the accounts as expenses (Art 26)

⁷ Decree-Law No. 4/90/M "Regulations of Depreciation and Amortisation on Fixed Assets"
Fixed assets are classified into 10 general groups.

10 Losses.

Losses for Group A company can be carried forward for three years to set off profits (Art. 34)

11 Profit reinvestment

Subject to the approval of the Chief Executive, profit not distributed which has been reinvested to acquire new equipment or facilities can be used to reduce taxable profit (Art. 35). In other words, these equipment or facilities are subject to 100% deduction of cost against profits.

12 Double Taxation Agreement

One of the major (interesting) advantages of a Macau Corporation or Offshore Institution is the availability of tax treaty. Macau has entered into a tax treaty with Portugal in 1999, aimed (presumably) as a way to protect the Portuguese's interest in Macau. Since Portugal is a member of the EU, an arrangement of structures in Macau and Madeira⁸ may become a gateway for Asia's export to Europe. A word of cushion – little experience has been accumulated in using DTA between Macau and Portugal. This is uncharted water.

Proper attitude towards tax planning

Nowadays, one of the most important duties of the manager of enterprises is to keep the enterprise afloat. The challenge in the 21st Century embraces the most fearful circumstances ever envisioned by the manager – rising costs, increasing governmental intervention, the shortening of the economic cycle, the increasing volatility of markets and the proliferation of “global village”. These have created a new scenario never been envisioned or studied.

Managers tried to control these fearful situations, or at least to predict the same so as to prepare for the best or the worst.

Take controlling costs as an example, the concept of “loyal employees” previously embedded in the business culture of Asia has gradually been replaced by “Western” style of scientific human resources management. Cutting cost is still the most important element.

⁸ Madeira is a part of Portugal and is a well-known asset and tax planning centre (‘tax haven’) in Europe. Madeira has a free trade zone which provides numerous tax and financial incentives and provides a gateway to other EU member countries.

When I begin my career in tax planning, the general thinking among Hong Kong entrepreneurs was from one extreme of “tax saving is evil” to another extreme of “paying tax is stupid”. Asset, operations and tax planning is a new subject to the society.

The objective of tax planning is always cost reduction and there is nothing wrong in reducing the running cost of your company as long as it is legal. I need not remind the audience about the proliferation of International Business Company of British Virgin Islands into the everyday life of Hong Kong Businessmen. Suffice to say that some “clever” businessmen still think that using BVI company to trade in Hong Kong is not subject to tax (which is wrong). As more and more businessmen use BVI company as tax reduction schemes, the Inland Revenue Department have been poking into and BVI company has been labeled as tax avoidance to tax evasion scheme.

In reducing the total cost of the company, I agree that tax is one of the most important elements. Profits tax among to almost 16% (to be increased to 17.5%) of a company's profits.

The nowadays concept of tax reduction has to be expanded into total cost reduction. What good is a tax reduction scheme to a company if the cost of running the scheme is more than the tax saved?

Using Macau structures have been discussed in media, amid that most of the concepts the media propaganda is wrong in principle and most of them are detrimental in effect.

As I have indicated at the beginning of this seminar, we shall concern ourselves with three kinds of structures only, Macau Corporation, Offshore Institution and Branch. We begin from a brief introduction of Macau Corporation.

Structure I : Macau Corporation

Macau corporations are not “shell” companies. Macau is a place to invest and Macau corporations are vehicle of investment. We can save cost by moving some of the operations to Macau.

A Macau corporation is a company registered under the Commercial Code of Macau which is either:-

1. An unlimited liability company
2. A mixed liability company by “Quotas”⁹

⁹ Quotas : this is the equivalent of “Stock”, a concept relative to “Share”.

3. A mixed liability company by shares
4. A limited liability company by “Quotas”
5. A limited liability company by “sole owner”
6. A limited liability company by shares

At present, only the type 4, type 5 and Branch Office may concern us here. In brief, the essential features of a Limited Liabilities Company are:-

	Number of owners	Capital	Form and participation of capital	Name ending with
Limited liability company by Quotas	2 to 30 persons	Minimum MOP25,000 (USD3,125). No maximum	By subscribing to the capital of the company at a minimum of MOP1,000(USD125) or in multiples of MOP100 (USD12.5)	Limitada (Lda)
Limited liability company by sole owner	1	-same as above	-same-	Sociedade Unipessoal Limitada

I shall not go into details about the incorporation of a Macau corporation, except I would like to point out that Macau is a code law jurisdiction. The incorporation procedures in Macau are not as simple as that in common law countries. In fact, attorney (Notary) is involved in the preparation and notarization of documents throughout the process. There is no restriction on foreign entities or individuals setting up corporations in Macau.

The corporation acquires legal personality upon registration with the Commercial Registry Office. A certificate of registration will be issued by Commercial Registry Office. Within 15 days after incorporation, the company should apply to the Department of Finance Services for declaration of commencement of operations, by completing Form M1 and submitting other documents.

Structure II : Branches

Setting up branches are easy, I have attached to this document a guide to establish a branch in Macao from IPIM¹⁰. Please note that there are no separate provisions in the Commercial Code relating to the control of Branch in Macau (unlike Part XI of the Hong Kong Companies

¹⁰ Guide to Investing in Macau, Supra P70 to 71

Ordinance), except that they have to be registered in accordance with the Commercial Registration Code¹¹ and could be liquidated by the government if not registered¹². All provisions in the Commercial code (except those controlling a local company) will apply to a branch, with “adaptation”¹³. A representative should be appointed in Macau.

As a branch does not have a corporate identity separated from its parent company and can be used in various form of asset and tax planning. A Hong Kong Company can be registered in Macau as a branch while subject only to the regulations of Hong Kong Companies Ordinance in respect of the relationship among its shareholders, but can conduct business in Macau and not subject to tax in Hong Kong.

Structure III : Offshore Institution

A very comprehensive introduction to the offshore laws relating to Offshore Commercial Services Institutions and Offshore Auxiliary Services Institutions can be found in the web sites of Manivest, which I shall not repeat here. What I would like to emphasis once more is the difference between OCSI and OASI.

To answer the questions I posed above, setting up an OASI is basically creating a back office to support operations in Hong Kong (or other regional offices, most notably China). No transfer pricing problems is envisioned as the only OASI can have no income and all expenses of the OASI will be born by its parent company.

Corporation Identity of OI

The question of whether an OI have a separate corporate identity in Macau depends on the mode of registration. If the OI is a Macau Corporation, or a branch of a foreign company that has is established as a corporation, it has a corporate identity. There is no provision in the Offshore Law to restrict the “legal identity” of the company applying for the approval of becoming an OI. This in fact allow for much imagination in asset and tax planning. Cushion – I do not think there is anyone ever tried to obtain an OI approval using a non-corporate body.

¹¹ Commercial Registration Code, Article 38, Commercial Code, Article 178(1)

¹² Commercial Code, Article 178(5)

¹³ Ibid, Article 178(4). Commercial Code contains regulations relating to commercial contracts, loan and debenture and other miscellaneous provisions relating to name of an enterprises, registration, accounting, civil liabilities.

Using Double Tax Treaty by OI

OI is a permanent resident in Macau. As I have cushioned above, little experience has been accumulated in using DTA between Macau and Portugal and this is uncharted water. Having said that, I am not able to see there is any adverse factor preventing Portugal to consider Macau OI to be benefited from the agreement, but as indicated in my discussion in the following paragraphs concerning DTA as applied to OI, it is technically impossible to be benefited from the DTA as “investment” is not an approved activity of an OI.

Structuring Macau Vehicles

The use of structures in asset and tax planning can be classified in different categories:

- (a) As investment holding companies
- (b) As (commission) agent, import and export documentation centre and back office.
- (c) As trading company on its own (“Triangular trading”)

There are of course some other structures that are not our concern today. We shall now discuss some of the issues.

(1) Investment Companies

The concerns of whether a type of vehicle could be used as the group’s investment vehicle are whether

- (a) There is dividend withholding tax
- (b) The shareholder (parent company) will be taxed.
- (c) Gain on disposal of a subsidiary/ branch is taxable.

Use of OI as investment company is not suitable as the purpose of OI, at the very beginning, is for the purpose of “ancillary services”, “back office”, “trading” and “services” and not for investment purpose. Moreover, investment is not a permitted offshore service allowable under the Offshore Law. Whether OI as an investment company to be qualified as a permanent establishment is another problem¹⁴. Of course, there is no provision in the law that does not

¹⁴ Article 5(4) of DTA deemed some of the activities permitted under the offshore law are not to be qualified, for example, maintenance of stock, purchasing merchandise or collecting information.

allow an OI, which is set up as a Macau Company, to invest in other companies.

In this connection, I do not recommend an OI to be used as a vehicle in investment. A Macau local company can of course be used. A sandwich structure Macau-> Madeira (Portuguese) Company -> EU Country Company is a feasible structure for cross-broader investment.

The DTA signed in 1999, although modeled after the OECD model convention, contains several provisions that are relevant to our discussion here- assuming we have a Macau company investing in Portugal, through a branch (Permanent establishment) or a subsidiary.

1. Article 4(1)(b) defines a resident, in case of Macau, is “any resident person or company who is subject to the territorial tax laws of Macau...by reason of his domicile, residence, place of management”. Therefore, a Macau Company, maintain a place of business in Macau is a resident in Macau and can be benefited from the DTA
2. Dividends, Interest, Royalty: the maximum rate of withholding tax that can be withheld by a Portuguese company is 10%¹⁵, instead of the usual 25% of non-treaty countries. Taking into consideration the benefit from the EU Directive on tax among members of EU, of which Portugal is a member, the benefit will be maximized if properly planned.
3. Capital Gains on disposal of permanent establishment (a branch) will be taxable in Portugal¹⁶ while **capital gain on disposal of shares investment in a Portuguese company will be taxable in Macau**¹⁷.

(2) As commission agent or import and export documentation centre

These are in fact permissible activities of OI. The establishment of an OI is qualified for tax exemption in Macau. If a Hong Kong Company is set up in Macau to conduct the aforesaid activities, this is merely a management decision to move some of the operation centre to a low-cost jurisdiction, thus saving tax as well as operation cost, given the running cost in Macau is only 60% of that of Hong Kong.

Having said that, I must remind the audience the followings:-

- 1 Although this scheme operates well because Hong Kong tax on on-shore income only and Macau tax are exempted, Anti-avoidance provisions of Hong Kong Inland Revenue

¹⁵ Article 10, 11 and 12 of the DTA between Macau and Portugal

¹⁶ Ibid, Article 13(2)

¹⁷ Ibid, Article 13(4) : “Gain from the alienation of any property other than that referred to in the preceding paragraphs shall be taxable only in the contracting State of which the alienator is a resident”. Since there is no provision in connection with the disposal of shares, the said gain on disposal is captured by this provision.

Ordinance (S60-S61A) and the principles demonstrated in *Furniss v Dawson*, *Rasmay*, *Craven v White* and *Ensign Tankers* still operate. Valid commercial reasons for establishment of a Macau operation center must be maintained otherwise anti-avoidance provisions may be applicable.

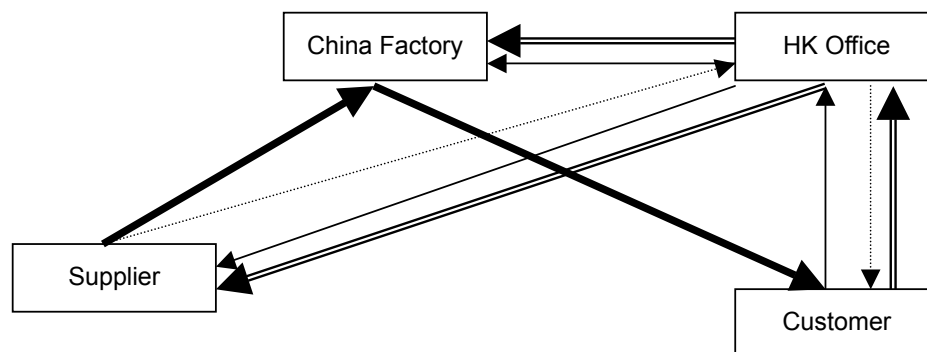
- 2 The principle is to move certain part of the HK operations to Macau. The severable part of the business can be one of the several permissible activities of OI. Please note that the fee chargeable from the OI to the parent company in Hong Kong is administration (service) fee and not commission.
- 3 A documentary processing centre is a highly feasible idea. In most cases, document processing needs only a term well-trained personnel that can be easily employed in Macau (or even from Hong Kong nowadays who wishes to settle in Macau). One point of cushion, the banking system of Macau may not be able cope with the volume of transactions and there is only a few banks which you could choose from.

(3) As a company trading on its own (Triangular Trade)

Before I go into detail of this, I would like to point out that Zhuhai, adjacent to Macau, is a Special Economic Zone which is five times larger than Shenzhen SEZ. Setting up in Zhuhai has been acknowledged as a more cost effective solution than Shenzhen. Macau is logically become the support centre of Zhuhai SEZ.

The use of Macau Company in trade-related planning is one of the most frequent questions. Fig A is the most frequent current trade arrangement

Fig A



One of the “model” which can be adopted is:-

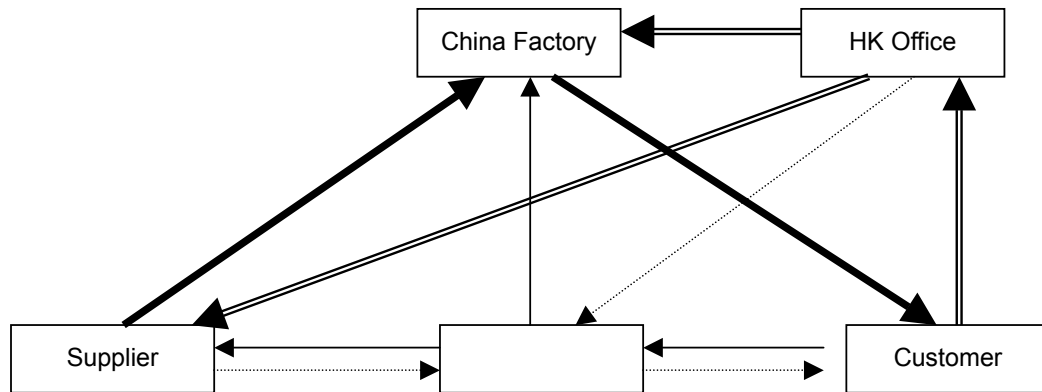
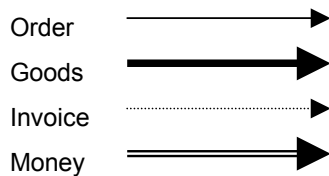


Fig B



In fig A, HK office is acting both as an administration centre and finance centre, but in fig B, Macau office is an administration centre but HK is a finance centre. Debit notes are raised from HK office to Macau office for services it provided to Macau Office in handling L/C and other finance related functions. In case that the Customer needs invoice from Hong Kong office, the Invoice can be issued from Macau office, on behalf of the Hong Kong Office (as agent) or the Macau OI is set up as a branch of the Hong Kong Company.

This may involve a big change to the company structure, because if the controlling centre is still in Hong Kong, as most company will, IRD of HK still consider the whole function is taking place in Hong Kong. This model will only work perfectly if the client’s director is willing to “settle” in Macau, or travel frequently to Macau to manage their business there.

An alternative way to settle this is to segregate a distinctive function to be performed by Macau OI, for example technical support centre, testing centre, data base services, ordering receiving centre, purchase office etc. Invoice will be raised from HK office but not from Macau office. Macau office will, again, raise invoice on administrative services to Hong Kong, thus reducing the profits assessable to tax in Hong Kong.

Remember that transfer pricing is still demands attention to a serious planner.

A useful concept – leasing an enterprise

“Leasing an Enterprises is one of the “strange” tools available¹⁸ in Macau.

Articles 114 to131 regulate the leasing of an enterprise to be operated not by the “owners”, but by third parties. The owner will receive remuneration in respects of the lease and the leasee receives all returns (and bears all losses) of the enterprise during the lease period.

It seems to be a new concept that “owning” a business and “running” a business is separated – but we can consider the arrangement from another point of view. The leasing of business is similar to receiving “Royalty” for allowing a third party to use the enterprise’s “brand name”, The only difference is that in a Royalty contract arrangement, the user of the “brand” own the entity in which the brand is used, while in a Lease-an-enterprise contract, the user actually run the leased enterprise and trade in name of the leased enterprise. The Commercial Code provides clear regulations of the post-and pre- contract liabilities. Some of the salient features are:-

- The contract will be lasted for five years, unless it is stated in the contract otherwise.
- The arrangement is also governed by “contract law” in the Civil Code
- There are provisions in protecting the owners, e.g. the leasee should not change the core business, disposing fixed assets of the enterprise, and engaged in competitive business without the permission of the owner.
- The leasee is obliged to return the enterprise to the owner when the contact is terminated.
- There are some provisions protecting the leasee, e.g., the owner should maintain “necessary, extra-ordinary up-keeping” to the enterprise and not to interrupt the operation of the enterprise, non-competitive.

When a lease is terminated, the fact has to be published in newspaper.

In common law jurisdictions, this kind of rent-a-business arrangement can be arranged by contact. The famous one is “Rent-a-captive” (rent a captive insurance business with a license) which is quite useful when the cost of obtaining a particular license is high and the time required is long.

Could a company with an OI be rent? Technically it is possible, but for the obligations and promises to be kept, the company may be subject to tight regulations that IPIM may impose, and its activities and size are limited by the business plan originally proposed by the business

¹⁸ Another tool is know as “use”, which is similar to Trust in common law jurisdictions.

owner.

The positive side of rent-a-business arrangement in Macau is that the owner and the management are totally separated. A business with long trading records can be rented. The arrangement is protected in law and there is no gray area as to the obligation and liabilities of each party.

In some cases, CFC rules and transfer pricing restrictions can be mitigated.

My time is limited and I think I have to stop now. If there is any questions, I shall be pleased to answer.

Horace Ho
April 8 2003

Reference

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- Web site of the Government of Macau SAR: www.macao.gov.mo
- Web site of the Instituto de Promocao do Comercio e Investimento de Macau: www.IPIM.gov.mo
- Various Fact Sheet relating to Macau published by Manivest Asia Limited

Appendix

Establishment of Branch Office in Macau

[Source : IPIM]

If a foreign company wants to set up a **permanent representation office** (a branch office) in Macao, the following documents should be provided:

1. The Memorandum and Articles of Association of the parent company

A notary from the country of origin should testify to the authenticity of the duplicate.

2. Minutes of the Board of Directors of the parent company

2.1 Appointment of representative: Parent company should assign one representative who has full authority to act of its behalf to sign the relevant constitutional documents for the branch.

2.2 The name of the branch. (Note 1: the branch should adopt exactly the same name as the parent company, however, the word "BRANCH" is an option to use.)

2.3 The scope of business. (Note 2: Since the nature of a branch is to develop and execute the business of the parent company, the business scope of the branch should be relevant to what is stated in the M&A of the parent company.)

2.4 Capital and its paid up time for the branch, address of the branch.

2.5 Appointment of at least 1 representative, who should be able to provide a residential address in Macao.

2.6 Signatories of the representative(s) necessary to uphold the company's responsibility.

3. A certificate issued by Notary Public in the country of origin, stating :

3.1 The company is duly formed and organized according to law

3.2 The signatories have full power to pass the Minutes

3.3 The authenticity of the signatures

3.4 Its legality under the M&A and the Company Act in the country of origin.

4. Letter of Acceptance of Appointment

Sign and declare by each representative of Macao.

-END-

How Manivest Asia Can Help You

The directors and management of Manivest Asia are professionals in the offshore industry having served the Asia markets for over fifteen years. Through our offices in Hong Kong, Shanghai and Macau as well as our associates in other Asia cities, we offer a full range of comprehensive value-added services to professional advisors and their clients.

Manivest Asia offers the following services:

- Incorporation of Hong Kong and other onshore/offshore companies and structures
- Full corporate management services
- Registered office, business office, mail redirection and business centre (available in selected locations only)
- Accounting services
- Re-invoicing services
- Asset protection and preservation advisory services
- Business establishment services
- Market exploration services

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