

Supplement II to the Mainland and Hong Kong Closer Economic Partnership Arrangement

To further enhance the level of economic and trade exchanges and cooperation between the Mainland¹ and the Hong Kong Special Administrative Region (hereinafter referred to as “Hong Kong”), and pursuant to:

the Mainland and Hong Kong Closer Economic Partnership Arrangement (hereinafter referred to as “CEPA”) signed on 29 June 2003 and its Annexes signed on 29 September 2003;

the Supplement to the Mainland and Hong Kong Closer Economic Partnership Arrangement (hereinafter referred to as “Supplement to CEPA”) signed on 27 October 2004;

the two sides agreed to sign this Supplement II on further liberalization of trade in goods and trade in services in the Mainland for Hong Kong, and on financial cooperation between both sides.

I. Trade in Goods

(1) From 1 January 2006, the Mainland shall fully implement zero tariff on imported goods of Hong Kong origin². Imported goods subject to zero tariff must fulfill the rules of origin confirmed after consultation by both sides.

The rules of origin for goods of Hong Kong origin for which consultations were completed by both sides in 2005 are listed in Annex 1 of this Supplement II. Annex 1 of this Supplement II is a supplement to Table 1 of Annex 2 of “CEPA” – “Schedule on Rules of Origin of Hong Kong Goods Subject to Tariff Preference for Trade in Goods”.

Both sides agreed to amend the detailed implementation procedures in Article 5 of Annex 1 of “CEPA” – “Arrangements for Implementation of Zero Tariff on Trade in Goods” as follows:

¹ In “CEPA”, the “Mainland” refers to the entire customs territory of China.

² Imported goods do not include those prohibited by the Mainland’s rules and regulations and those prohibited as a result of the implementation of international treaties by the Mainland, as well as products that the Mainland has made special commitments in relevant international agreements.

“(1) Submission

1. From 1 January 2006, Hong Kong manufacturers may submit lists of goods subject to zero tariff to the Hong Kong Trade and Industry Department.
2. The Hong Kong Trade and Industry Department shall, prior to 1 March and 1 September each year respectively, submit the list of goods verified and certified in accordance with relevant rules of the Hong Kong Special Administrative Region Government to the Ministry of Commerce.

(2) Consultation and Promulgation

The Ministry of Commerce shall confirm and then pass the list of goods to the Customs General Administration. The Customs General Administration and the Hong Kong Trade and Industry Department shall enter into consultation on the rules of origin for the relevant goods. The two sides shall complete the consultations on the rules of origin before 1 June and 1 December each year respectively, add the rules of origin of the relevant goods to Table 1 of Annex 2 of “CEPA”, and promulgate them.

(3) Implementation

The Mainland shall, no later than 1 July of the same year and 1 January of the following year respectively, release the relevant imports on zero tariff basis in line with “CEPA” upon presentation of the certificates of origin issued by the Hong Kong issuing authorities.”

(2) Article 5 of Annex 2 of “CEPA” – “Rules of Origin for Trade in Goods” is amended as follows:

“5. On the criteria for ‘substantial transformation’ set out in Article 2 (2) of this Annex, the two sides agree on the following:

- (1) the criteria for determining ‘substantial transformation’ may include ‘manufacturing or processing operations’, ‘change in tariff heading’, ‘value-added content’, ‘other criteria’ or ‘mixed criteria’;

1. 'manufacturing or processing operations' refers to the principal manufacturing or processing operations carried out in the area of one side which confer essential characteristics to the goods derived after the operations;
2. 'change in tariff heading' refers to the processing and manufacturing operations of non-originating materials carried out in the area of one side and resulting in a product of a different four-digit tariff heading under the 'Product Description and Harmonized System Codes'. Moreover, no production, processing or manufacturing operations will be carried out in countries or territories other than that side which will result in a change in the four-digit tariff heading;
3. 'value-added content' refers to the total value of raw materials, component parts, labour costs and product development costs exclusively incurred in one side being greater than or equal to 30% of the FOB value of the exporting goods, and that the final manufacturing or processing operations should be completed in the area of that side. The formula for calculation is as follows:

$$\frac{\text{value of raw materials} + \text{value of component parts} + \text{labour costs} + \text{product development costs}}{\text{FOB value of the exporting goods}} \times 100\% \geq 30\%$$

- (i) 'product development' refers to product development carried out in the area of one side for the purposes of producing or processing the exporting goods. Development expenses incurred should be related to the exporting goods. These expenses include fees payable for the development of designs, patents, patented technologies, trademarks or copyrights (collectively 'these rights') carried out by the manufacturer himself, fees payable to a natural or legal person in the area of one side for undertaking development of these rights, and fees payable for purchasing these rights owned by a natural or legal person in the area of one side. The fees payable should be clearly identifiable under generally accepted accounting

principles and the requirements of 'Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994';

(ii) calculation of the above 'value-added content' will be consistent with generally accepted accounting principles and the 'Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994';

4. 'other criteria' refers to methods agreed by both sides in determining 'substantial transformation', other than 'manufacturing or processing operations', 'change in tariff heading' and 'value-added content' as set out above.

5. 'mixed criteria' refers to the use of two or more of the above criteria in determining origin.

(2) other additional conditions. If the 'substantial transformation' criteria set out in paragraph (1) above are not adequate for determining origin, additional conditions can be used (such as brand requirement, etc) upon agreement by both sides."

II. Trade in Services

(1) From 1 January 2006, the Mainland shall further relax the market access conditions in the areas of legal, accounting, audiovisual, construction, distribution, banking, tourism, transport and individually owned stores on the basis of the commitments on liberalization of trade in services under "CEPA" and "Supplement to CEPA". The specific contents are detailed in Annex 2 of this Supplement II.

(2) Annex 2 of this Supplement II is a supplement and amendment to Table 1 of Annex 4 of "CEPA" – "The Mainland's Specific Commitments on Liberalization of Trade in Services for Hong Kong" and Annex 3 of "Supplement to CEPA" – "Supplements and Amendments to the Mainland's Specific Commitments on Liberalization of Trade in Services for Hong Kong". In the event of conflict with the provisions of the other two instruments, the provisions of Annex 2 of this Supplement II shall prevail.

(3) “Service suppliers” as referred to in Annex 2 of this Supplement II shall meet the relevant requirements of Annex 5 of “CEPA” – “Definition of “Service Supplier” and Related Requirements”.

III. Financial Cooperation

(1) The Mainland shall allow qualified Mainland securities companies which belong to the pilot innovation type to set up subsidiaries in Hong Kong in accordance with the relevant requirements.

(2) The Mainland shall allow qualified Mainland futures companies to operate futures business in Hong Kong, including the setting up of subsidiaries.

IV. Annexes

The Annexes to this Supplement II form an integral part of this Supplement II.

V. Coming into Effect

This Supplement II shall come into effect on the day of signature by the representatives of the two sides.

Signed in duplicate in Hong Kong, this 18th day of October, 2005 in the Chinese language.

Vice Minister of Commerce

Financial Secretary

People’s Republic of China

Hong Kong Special
Administrative Region of the
People’s Republic of China