MOORE STEPHENS

Doing business in China

China

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Doing business in China

Market entry for foreign investment

Business sectors open for foreign investment

After joining the World Trade Organization (WTO) in 2001, China has opened most of its business sectors to foreign investment. Currently, there are just a few business sectors in certain industries prohibited or restricted to foreign investment. On the other hand, there are certain business sectors in which foreign investment is much encouraged by the Chinese government to engage.

According to China's latest Foreign Investment Guideline, the business sectors for foreign investment can be classified under the following categories:

Encouraged (e.g. food production)
Special government support and preferential tax treatment may be available for foreign investment entities setting up for 'encouraged business'.

Allowed (e.g. general trading, service)
Generally, 100% foreign shareholding is allowed in setting up companies for 'allowed business'.

Restricted (e.g. transport and communication facility construction)
Generally, Chinese participation is required and 100% foreign shareholding is not allowed for 'restricted business'.

Prohibited (e.g. power supply, publishing)
Basically, the government does not allow foreign investment at all.

Common Foreign Investment Vehicles

Foreign Investment Enterprises (FIE)

FIE include the following type of investment vehicles:

Wholly Foreign Owned Enterprise (WFOE")
A WFOE is a limited liability company established solely with foreign capital.

Equity Joint Venture (EJV)
An EJV is a separate legal entity with limited liability. The profits and losses are distributed according to the ratio of each investor's capital contribution, i.e. equity. An EJV must have at least one Chinese investor.

Contractual Joint Venture ("CJV")
A CJV may operate as a non-independent or independent legal entity. The profit and loss distribution ratio is defined in the JV contract and can vary over the contract terms agreed by all the investors. A CJV must have at least one Chinese investor.

Joint venture entities between foreign investors are treated as a WFOE in China (instead of EJVs or CJVs). The most common setup WFOEs are:

- manufacturing WFOE (which manufactures and sells its own products in China);
- trading WFOE (which is either a trading company or a retailer in China);
- service WFOE (which provides all kinds of general services); and
- a WFOE doing a combination of manufacturing, trading and service.

Representative Office (RO)
An RO is a China office of a foreign company without a legal corporate status of itself in China. An RO is normally used for non profit making activities in China such as liaison, marketing research in China for its foreign head office.

An RO is a simple and inexpensive way for establishing a presence in China and can be generally used for:

- conducting market research;
- product promotion;
- facilitating control or monitoring purchasing activities;
- marketing administration for sales conducted in China by the foreign group company; and
- administration for group activities in China.

An RO cannot be involved in any business activity in China, including signing a sales/service contract or receiving sales proceeds. The only funding of an RO should come from its foreign head office company and it can only be run as a cost centre in China without any incoming revenue from business activities.

An exception is law firms. Foreign law firms are required to be setup in the form of ROs but they can engage in profit making legal services in China.

Branches
Currently, only foreign financial institutions (such as banks) have been allowed to setup branches in China. Other than for banks,

branches are not a common vehicle for doing business in China.

Foreign Enterprises (FE)

In general, FE refers to all enterprises and companies registered and established outside China. An FE may have the opportunity to do business in China directly by sending people onshore.

Set-up a WFOE in China

Despite the different requirement of setting up different kinds of WFOE and the local implementation differences which exist in each different location throughout China, the major steps involved in setting up all kinds of WFOE are similar across the country, and include:

- discuss the proposed business scope of the WFOE and any particular requirements with the local approval authority, usually the local office of the Ministry of Commerce (MoC);
- prepare the necessary application for company Name Registration;
- prepare the formal application packages, including the Feasibility Study Report and the company's Articles of Association, and other letters and forms, to apply for Approval Certificate with local MoC; and
- register with the local branch of the Administration Bureau for Industry and Commerce ("ABIC") to apply for a Business License.

Upon the issuance of the Business License, the WFOE is legally setup, but the setup procedure is just half way through. It must also register with other government authorities, e.g. tax, customs, etc., for all the post-establishment registrations.

Setup an RO in China

The major steps for establishing an RO are:

- prepare the setup registration application, including:
  - head office company documents: certificate of incorporation, business registration document, bank reference letter, board resolution, etc.;
  - lease agreement of a physical RO office in the city where the RO is going to be registered;
  - Chief Representative's documents – letter of appointment, resume, etc.;
  - other application forms and letters;
- register with the local ABIC to apply for a Business Registration Certificate;
- register with the other government authorities for the post-establishment registrations, including:
  - Technology Supervision Bureau;
  - Public Security Bureau;
  - State and Local Tax Bureau;
  - State Administration for Foreign Exchange;
  - Statistic Bureau; and
  - Customs Office.

Foreign contractors in China

Foreign contractors and their staff are also subject to Chinese registration requirements, corporate taxes and individual taxes. With foreign exchange controls in place in China, a proper structure is needed for project execution and implementation and this will help ensure safe receipt of all relevant payment overseas with minimum tax costs.

All foreign enterprises engaged in approved 'business activities' in China should register with the local ABIC.

'Business activities' include:

- contracting or decorative work on real property;
- civil engineering projects; and
- circuit or pipeline engineering projects and the installation of related facilities; and other service project in China to be required to register locally.

Contractors shall, within 30 days after the receipt of a business license, complete tax registration formalities with the tax authorities.

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FAQs before business presence setup in China

What is an FIE?

The term Foreign Investment Enterprise (FIE) usually includes: Wholly Foreign Owned Enterprise (WFOE), Equity Joint Venture (EJV) and Contractual Joint Venture (CJV).

Would a Hong Kong company qualify as a Chinese company?

No. Hong Kong is still regarded as a foreign jurisdiction in China's corporate, tax and fiscal systems. Thus, a Hong Kong company is regarded as a 'foreign' company instead of a Chinese one, e.g. an FIE.

What is a WFOE?

WFOE stands for Wholly Foreign Owned Enterprise and is a China registered limited liability company which is 100% owned by one or several foreign individual(s) or company(ies).

What can a WFOE do for business in China?

An WFOE is classified as such because of the percentage of its foreign shareholding. It could be a service company (i.e. a Wholly Foreign Owned Service Company or WFOSC), a trading or retailing company (i.e. a Foreign Investment Commercial Company or FICE WFOE), a manufacturing factory (a manufacturing WFOE or a WFOE factory), as long as the proposed business scope is in line with the relevant foreign investment market entry regulations.

Is there anything an WFOE not allowed to do in China?

Yes, there is still certain business sectors restricted or prohibited for foreign investment. Professional advisory according to China's WTO Commitment – Market Entry section, China's latest Foreign Investment Industry Guideline, as well as domestic FDI regulations is necessary.

Where in China can I setup a WFOE?

Everywhere. Again, professional advice on local practices for both the setup requirement and reporting requirement in day-to-day running is necessary prior to making a decision on where to invest in China.

Why choose an EJV or a CJV?

Apart from the normal benefit from having a local Chinese partner such as more familiar with local market conditions, possessing established supply, sourcing or sales network and local government connection, an EJV or CJV is also an option to overcome market entry restrictions to a WFOE in certain business sectors.

EJV vs CJV?

A CJV may not be a limited liability company, whilst an EJV has to be.

The partners in a CJV share the profit and loss irrespective of their equity interest, whilst EJV partners have to divide their share of the profit and loss according to the percentage of their equity interest.

Foreign Investment Commercial Company ("FICE") vs WFOE?

FICE is classified by the business activity it is engaged such as trading, retailing, franchising, whilst a WFOE is classified by the foreign shareholding percentage (i.e. 100%) FICE, from the foreign shareholding percentage perspective, could either be a WFOE, a CJV or an EJV. In general FICE is an FIE engaged in one or all of trading, retailing or franchising in China or cross-border.

What are the initial considerations to bear in mind when planning to setup a presence in China?

- location;
- type of investment vehicle;
- a physical office;
- individuals for statutory positions;
- business scope;
- registered capital;
- total investment & thin capitalization rule in China;
- once setup, the company must be capitalized and running; and
- file monthly, quarterly and annual tax, corporate and fiscal reporting.

China Taxation

The major types of taxes which may be triggered in doing business in China are:

Income Tax

- Enterprise Income Tax (EIT), (including Withholding Tax); and
- Individuals Income Tax (IIT).

Turnover Tax

- Value Added Tax (VAT);
- Business Tax (BT); and
- Consumption Tax (CT).

Other Taxes

- Stamp Duty (SD).

Enterprise Income Tax

Basic law:

Enterprise Income Tax Law of the People's Republic of China (effective on January 1, 2008).

Implementation Rule of Enterprise Income Tax Law of the People's Republic of China (effective on January 1, 2008).

Tax rate:

25%.

Taxation base:

Taxable Income (adjusted according to EIT Law and its implementation rules and regulations from the audited accounting profit).

Filing requirement:

Quarterly provisional filing.

Annual reconciliation filing.

Individuals Income Tax

Basic law:

Individual Income Tax Law of the People's Republic of China (latest amendment effective on September 1, 2011).

Implementation Rule of Individual Income Tax Law of the People's Republic of China (latest amendment effective on September 1, 2011).

Tax rate (for remuneration income):

Taxable income after the Standard Deduction			Tax rate %
0	-	1,500	3
1,500	-	4,500	10
4,500	-	9,000	20
9,000	-	35,000	25
35,000	-	55,000	30
55,000	-	80,000	35
Above 80,000			45

Taxation base (for remuneration):

Monthly gross wage.

Filing requirement:

Monthly filing.

Annual reconciliation filing (annual filing should include all kinds of income derived in the year, not just remuneration).

Value Added Tax

Basic law:

Provisional Regulations of the People's Republic of China on Value Added Tax (effective on January 1, 2009).

Implementation Rule of Provisional Regulations of the People's Republic of China on Value Added Tax (effective on January 1, 2009).

Tax rate:

17% (3% for small size taxpayer).

Filing requirement:

Monthly filing.

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Business Tax

Basic law:

Provisional Regulations of the People's Republic of China on Business Tax (effective on January 1, 2009).

Implementation Rule of Provisional Regulations of the People's Republic of China on Business Tax (effective on January 1, 2009).

Tax rate:

3% – 20% depending on the service type.

Taxation base:

Gross service income.

Filing requirement:

Monthly filing.

Consumption Tax

Basic law:

Provisional Regulations of the People's Republic of China on Consumption Tax (effective on January 1, 2009).

Implementation Rule of Provisional Regulations of the People's Republic of China on Consumption Tax (effective on January 1, 2009).

Filing requirement:

Monthly filing.

Stamp Duty

Basic law:

Provisional Regulations of the People's Republic of China on Stamp Duty (effective on January 1, 2009).

Implementation Rule of Provisional Regulations of the People's Republic of China on Stamp Duty (effective on January 1, 2009).

Tax rate:

0.03% – 0.1%.

Taxation base:

Dutiable value.

Filing requirement:

Upon incurrence.

China foreign exchange control

China regulates both the inflow of foreign exchange and all foreign exchange expenditure and outward remittances. In China, the foreign exchange authority is the State Administration of Foreign Exchange (SAFE), and all banks are regulated by both the People's Bank of China (the central bank) and SAFE.

In practice, approval from SAFE for foreign exchange out of China and reporting to SAFE for foreign remittance into China are both required. China tax clearance is always required for outward remittances and different arrangements may trigger different tax implications and incur different tax costs. Thus, with the proper structure and documentation in place, approval can be obtained for remittance of funds out of China with possible minimum Chinese tax costs.

Employment in China

Work Permit

Foreign employee must obtain a Work Permit before they may commence employment in China. A foreign employee must be at least 18 years of age and in good health, and must possess the professional skills and working experience required for the work of intended employment. Work Permit shall be applied for in the city where the foreign employee is working.

Residence Permit (working visa)

Foreign employee must apply for Resident Permit in the city where the foreign employee is working and residing after obtaining his/her Work Permit, which is normally valid for 1 year. The Residence Permit once issued is also the working visa with multiple entry allowed into China.

Social Security System

Social security is statutorily required for all the Chinese employees, but not yet applied in practice to foreign employees.

The social security systems are different in every city, but normally including the following:

- pension;
- unemployment insurance;
- medical insurance;
- occupational injury insurance;
- childbirth insurance; and
- housing fund.

The employer's contribution to the social security system for an employee every month is basically about 40% (differing from city to city) the higher of his/her gross monthly pay or the 3 times of the city's previously average monthly wage announced by the city government.

Moore Stephens globally

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