

Establishing a Business In China

The Red Synergy

The following is based on our understanding of relevant PRC Law and practice and our experience in representing foreign companies in their business activities in the PRC. As a foreign company we are not authorised to practice law in the PRC and cannot express a formal legal opinion on PRC law. The application of PRC laws and policies regarding the activities of foreign enterprises in the PRC is constantly evolving.

Accordingly this advice is necessarily preliminary and subject to confirmation from the relevant Chinese authorities.

Many people say that: “Anything is possible in China,
but simple things have a tendency to be difficult”

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- Foreign Direct Investment (FDI) environment in China

Foreign Direct Investment (FDI) environment in China

China's FDI environment has improved significantly and the country is bound to attract more FDI in the future

- USD 14.25 bln used, in Q1 2006 in China.
- USD 60.3 bln used in 2005 in China.
- USD 6.85 bln used, and 13.83 bln contracted in 2005 in Shanghai.
- The number of new registered enterprises is up 4097 (FIEs) in Shanghai.
- More favorable and flexible FDI policies, ex. VAT refund policies, and profit repatriation policy.
- Registration capital & registration procedures.
- WTO commitments.
- 2008 Olympic Games in Beijing, and 2010 World Expo in Shanghai.

US-China trade

- According to US Custom statistics, in 2005, the US imported USD 243.4 bln from China and exported 41.8 bln to China during the same period.
- As a result of this trends, the bilateral trade deficit with China increased to USD 201.6 in 2005.

- FDI professional advice

FDI's Professional advice

Solid professional advice and expertise is necessary before you start

- Reduce investment risk.
- Achieve more efficient set-up procedures.
- Ensure smooth operations and profitability in the future.
- Be in accordance with Chinese laws and regulations.

Adopting different business structures will significantly influence your business's profitability, and effectiveness.

- Business structure and their tax/financial implications
- Main issues of setting up a company in China
- Type of business structure
- Main taxes involved in doing business in China

Main issues of setting up a company in China

- The set up process is highly regulated by Chinese authorities.
- Chinese national and local authorities issue special laws to discipline and implement every kind of business.
- Local authorities are free to design special laws and allow preferential treatment in order to attract more investment.
- Local tax rates can vary substantially in accordance with the policy adopted by the region.

Type of Business structures

Adopting different business structures will significantly influence your business's profitability, and effectiveness.

- Representative office (RO).
- Wholly foreign owned enterprise (WFOE).
- Joint venture (JV).

Type of Business Structures

Representative Office (RO)

Main features

- A good way for entering into China with low risk at initial stage.
- Business scope: acting as a liaison between parent company and entities in China, market research, QC facilitation and monitoring purchasing activities, and developing activities.
- Open to almost all countries and industries.
- For some special industry the approval needs to be done at Ministry level (Inspection & Qualification firm, Law firm).
- Legally, it can't conduct real business transaction.
- No capital requirement for registration.
- RO can only pay for the office operational cost.
- RO tax is 10% on the total expenses filed every quarter.
- Proper bookkeeping and annual audit is required.
- Not a good solution for further market activities, particularly more transactions will be needed.

Type of Business Structures

Wholly foreign owned enterprise (WFOE)

Main features

- The most popular option in China.
- Normal industries: manufacturing, IT and trade industry. Some industries are restricted and need more approval procedures, like training, HR.
- Capital requirement for registration in Shanghai:

Manufacturing	USD 200,000;
Consulting	USD 140,000;
Trading	USD 60,000.

- Investment forms: cash, equipments or technology

Registration process of different types of WFOE

- Manufacturing
Feasibility study : production procedure, environmental factors, financial budget and detailed equipment list and etc.
Environmental evaluation report: needs to be approved by the authorities.
- Consulting
The environmental report is not required
Feasibility study report will be quite straight forward
The process is normally 2 to 3 months.
- Trading
Trading WFOE in free trade zones
Trading WFOE under new regulation of 11th Dec 2004.

Type of Business Structures

Joint Venture (JV)

Main features

Company formed by a foreign company or individual investor with more than 25% of shares together with Chinese company. Chinese partner can't be an individual.

This structure was very popular 10 to 15 years ago, such as an automotive, recruitment, media, accounting or law professional firms and etc.

Some industry still require foreign investors to use this structure to entry the China market.

Advantages

- Smaller investment since your Chinese partner will contribute the other portion.
- Easier and quicker entering into Chinese market (Chinese partner's existing purchase or sales channel can be used for the new JV).
- Avoid culture shock.

Disadvantages

- Different management style leads to a longer decision making process.
- Strategic interests are different (long term and short term): "*...same bed, different dreams*".
- In case of company liquidation, it is necessary that both parties agree on it.

Type of Business Structures

Joint Venture (JV)

Experiences

- Put one party under control position.
- Avoid 50:50 or 49:51 structure.
- Carefully choose your partner (due diligence).
- Audit and evaluation is necessary.
- Financial report might have been altered.

Main taxes involved in doing business in China

Corporate Income Tax

- It is applicable to all foreign companies that derive income in and out of China.
- It is calculated against the gross income in a fiscal year. The tax rate is 25%.
- The Transitional Preferential CIT Policies implemented on 1 January, 2008.
- An enterprise that enjoy the 15% enterprise income tax rate shall be subject to
2007 15% 2008 18% 2009 20%
2010 22% 2011 24% 2012 25%
- An enterprise that previously enjoyed the 24% tax rate shall be subject to the 25% tax rate starting the year of 2008.
- An enterprise that previously enjoyed tax holiday shall continue to enjoy preferential treatment for their initial term as proscribed under the previous tax laws until the initial term expires; an enterprise that has not started enjoying preferential tax treatment because it has not made a profit shall commence the term of preferential tax treatment in the year 2008.

Main taxes involved in doing business in China

Main Features of Business tax and VAT tax

- **Business Tax**
Business tax is calculated against turnover and is payable by all enterprises (and individuals) that provide services. The tax rate is 5%.
- **VAT Tax**
VAT is tax for selling products.
Tax levied on revenues.
The normal VAT rate is 17%.

Others

- **Pay either of the two when generate income**
But VAT more for manufacturing and trading company ,while a consulting may only need to pay BT, no VAT involved.
- **One company might have both VAT and BT**
Sell products and provide charged services.
Accounting system is required strictly to separate these two sort of income.

Main taxes involved in doing business in China

VAT refund

- Companies that export their products, if these products are produced in China or the parts are purchased in China, qualify for VAT refund from government rather than from their export clients.
- The time to refund procedure has been shortened to 2/3 months.
- You can use Import & Export company to deal with VAT refund.

Main taxes involved in doing business in China

WFOE Major accounting requirements

- Using calendar year as your fiscal year.
- Bookkeeping has to be in Chinese and according to PRC accounting standard.
- Software issues.
- Need Annual audit and inspection for all WFOE.
- 10% of net profit after tax needs to be reserved before distribute dividends and repatriate overseas until the total of reserved fund is cumulated up to 50% of registered capital.
- Most closest accounting standards is IAS.