DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

AN INTRODUCTION TO

DOING BUSINESS IN CHINA 2015

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This edition of Doing Business in China was produced by a team of professionals at Dezan Shira & Associates, with Samuel Wrest and Matthew Zito as managing editors and Qian Zhou as technical editor. Creative design of the guide was provided by Jessica Huang and Estela Mi.

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ABOUT DEZAN SHIRA & ASSOCIATES

At Dezan Shira & Associates, our mission is to guide foreign companies through Asia's complex regulatory environment and assist them with all aspects of establishing, maintaining and growing their business operations in the region. Since its establishment in 1992, Dezan Shira & Associates has grown into one of Asia's most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore and Vietnam, as well as liaison offices in Italy, Germany and the United States, and partner firms across the ASEAN region. With over 20 years of on-the-ground experience and a large team of professional advisers, we are your reliable partner in Asia

PREFACE

ALBERTO VETTORETTI
Managing Partner
Dezan Shira & Associates

Now the world's second largest economy and long since the most populous nation on earth, China offers enormous opportunities for foreign companies, both as a manufacturing labor pool and increasingly, as a consumer market of seemingly endless potential.

In the 30 years since Deng Xiaoping's "reform and opening-up" policy of 1978, China's GDP has developed at an unprecedented rate, averaging 10 percent growth per annum. After years of red-hot economic activity, in 2013 the country's growth slowed to 7.7 percent - a trend that continues to raise concern about the future viability of investment into "the world's factory."

To the discerning eye, however, the mature Chinese economy of today presents a set of different but equally encouraging signals for foreign investors: firstly, that China is prepared to sacrifice rapid growth for long-term economic reform, paving the way for greater "market liberalization" of key industries that have long remained the exclusive domain of state-owned enterprises, such as telecom and finance.

Second is policymakers' commitment to moving towards a consumer society more reliant on the services sector than the heavily polluting and low-value added manufacturing on which the Chinese economy cut its teeth. Meanwhile, decades of prosperity and rising wages have given rise to a growing number of young professionals, whose aspirations toward higher standards of living are fueling a nationwide retail boom.

Lastly, in their drive to address export markets, Chinese businesses have developed an appetite for technology, systems and infrastructure that cannot be easily satisfied by domestic suppliers, to the benefit of foreign companies specializing in automation, logistics and corporate training. Combined, these trends are creating opportunities in China's emerging tertiary industry for a new generation of foreign-invested enterprises.

Designed to introduce the fundamentals of investing in China, this publication is compiled by the experts at Dezan Shira & Associates, a specialist foreign direct investment practice, providing corporate establishment, business advisory, tax advisory and compliance, accounting, payroll, due diligence and financial review services to multinationals investing in emerging Asia.

Since its establishment in 1992, the firm has grown into one of Asia's most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore and Vietnam as well as liaison offices in Italy, Germany and the United States.

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MAIN GOVERNMENTAL ORGANS

Despite ongoing liberalization, China's business environment remains riddled with bureaucratic hurdles, with the country ranking 96th out of 185 economies surveyed in the World Bank's 2014 'Ease of Doing Business' report. Presented here is a selection of the main governmental organs and departments with whom foreign investors will most commonly interact.

The People's Congress of China is the supreme organ of state power, within which the Standing Committee exercises the legislative function. Local People Congresses at various levels of administration represent the state at a local level.

The State Council of China is the supreme administrative organ of the state, and the executive organ of the People's Congress; local governments serve as the executive organs of state power and administrative organs in local jurisdictions, under the leadership and command of the State Council.

People's Courts at different levels are the judicial organs of the country, divided between local courts, Special People's Courts and Supreme People's Courts. The local-level People's Courts are further divided into Basic-Level Courts, Middle People's Courts and Higher People's Courts, tasked with handling cases of varying magnitude and reviewing appeals on an ascending basis.

Key departments:
The Ministry of Commerce (MOFCOM, Ch: 中华人民共和国商务部), under the auspices of the State Council, is an executive agency tasked with steering policy decisions on foreign trade, import/export procedures, foreign investment, consumer rights and market competition, in addition to negotiating trade agreements on behalf of China.

The State Administration of Taxation (SAT, Ch: 国家税务总局), is the highest tax authority in China, authorized by the State Council to oversee the country's tax system, draft national tax regulations (sometimes in conjunction with the Ministry of Finance), provide support in developing national tax and economic policies, and execute the collection and administration of taxes attributed to the central government.

The State Administration of Foreign Exchange (SAFE, Ch: 国家外汇管理局) is an administrative agency responsible for managing foreign exchange activities in China, setting relevant regulations, and administering China's foreign exchange reserves. SAFE approval or record-filing is required for a range of transactions involving inbound and outbound forex payments.

The State Administration for Industry and Commerce (SAIC; Chinese: 国家工商行政管理总局) is the state-level authority charged with guiding legislation related to the administration of industrial and commercial activities. SAIC's local iterations (local "AICs") oversee the registration and licensing of enterprises within their respective jurisdictions.

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WHAT ARE MY OPTIONS FOR INVESTMENT ?

RICHARD CANT
Director
North America

"Choosing an investment structure depends largely on your goals in China. For companies looking to target the Chinese consumer, the foreign-invested commercial enterprise (FICE) has become the gold standard investment model."

Foreign investment into the People's Republic of China (hereafter "China") can be made via one of several types of foreign-invested entities (FIEs). Choosing the appropriate investment structure for your business depends on a number of factors, including its planned activities, industry, investment size, etc.
In this section, we discuss:

a. Representative Offices
b. Joint Ventures
c. Wholly Foreign-Owned Enterprises
d. Other investment options

Key points that differentiate investment structures include:

Business scope

The business scope is a one-sentence description of the commercial activities in which a business is authorized to operate in. For foreign businesses especially, it is imperative that company operations be reflected accurately in their business scope, as this is connected to the "Catalog for the Guidance of Foreign Invested Enterprises" governing foreign investment into China. An enterprise's business scope is administered by two state bodies—the Ministry of Commerce (MOFCOM) and the local Administration of Industry and Commerce (AIC) of registration—and is printed on its business license along with other registered information such as its name, registered capital, and legal representative.

Keeping your company's commercial operations within the range of activities set out in its registered business scope is important for several reasons. In addition to the legal risk of disingenuously operating in an unregistered domain, doing so can also be detrimental to a company's ability to issue official invoices (fapiao) to its clients, which are necessary for offsetting the value-added tax liability of both a selling company and its purchasers. It is therefore critical that companies carefully plan their business scope prior to initial incorporation in China, else undergo the onerous and time-consuming process of changing this later (outlined below).

Registered capital

Registered capital is the initial investment in a company required to fund its business operations until in a position to fund itself. According to the revised Company Law (effective March 1, 2014), the minimum registered capital requirements for corporate establishment have been removed, and the previous system of paid-up capital replaced by a subscribed capital model (under which a schedule of contributions must be registered with SAIC). Additionally, the requirement that 30 percent of one's registered capital must consist of a cash contribution was removed.

One thing to note is that although the restrictions on first-time capital contributions have been cancelled, in practice, the governing authorities will ensure that a company's registered capital is sufficient to support its business operations for at least one year, including its rent, labor costs and office expenses. Moreover, FIEs are still required to abide by the ratio between registered capital and total investment as shown in the following chart. Unlike registered capital, total investment represents the debt of the investment and can be made up by loans from the investor or foreign banks.

INVESTMENT-TO-CAPITAL RATIOS	
Total Investment (US$)	Minimum Registered Capital
3 million or less	7/10 of total investment
3 million - 4.2 million	US$2.1 million
4.2 million - 10 million	1/2 of total investment
10 million - 12.5 million	US$5 million
12.5 million - 30 million	2/5 of total investment
30 million - 36 million	US$12 million
36 million or greater	1/3 of total investment

Registered capital contributions can be made in cash or in kind, as a lump sum or in installments. However, locally obtained RMB cannot be injected as registered capital - it must be contributed from outside China by the overseas investor. The company's payment schedule for contributions must be specified in its Articles of Association, and once paid, the amount cannot be wired out again freely.

Legal personality liability

A company in China (representative offices not included) is an enterprise legal person, bearing civil liability for the operational activities of its legal representative and other staff. The company is liable for its debts to the extent of its entire property. The shareholders of a company with limited liability status assume liability towards the company to the extent of their subscribed capital contributions, respectively.

In addition to the options discussed in the following pages, some investors choose to invest in China via a merger and acquisition (M&A). Acquisition of equity and assets requires approval from the enterprise's local Ministry of Commerce and registration with its local Administrative Bureau of Industry of Commerce. Investors considering an M&A should conduct thorough due diligence on target companies (see chapter 2 for more information on this), guided by the experience of a professional services firm.

Representative office (RO)

A representative office (RO) is an attractive way for foreign investors to get a feel for the Chinese market, as it is the easiest type of foreign investment structure to set up and has no registered capital requirements. The defining characteristic of an RO is its limited business scope: ROs are generally forbidden from engaging in any profit-seeking activities and can only legally engage in:

- Market research, display and publicity activities that relate to the company's product or service; and
- Networking activities relating to sales of the company's product or its provision of services, and domestic procurement and investment.

Unlike more robust vehicles such as the WFOE, an RO has no legal personality, meaning it does not possess the capacity for civil rights and conduct, cannot independently assume civil liability, and is limited in its hiring ability. Local employees can only be hired through government HR agencies and no more than four foreign employees can be hired per RO.

ROs are taxed as a permanent establishment in China, and are required to pay corporate income tax on their profits, as well as business tax and value-added tax, which usually amounts to a liability of approximately 11-12 percent of the total expenses of the RO.

Joint venture (JV)

A joint venture (JV) is a limited liability company formed by a foreign investor(s) or a foreign individual, along with a partnered Chinese company. Generally, the foreign investor to a JV should own at least 25 percent of total shares. Note that a Chinese individual cannot normally be a shareholder in a JV except in some special circumstances – for example, in a JV incorporated in Beijing Zhongguancun High-tech Park, or if the Chinese individual is shareholder to the target company in a merger or acquisition.

Reasons for setting up a JV include:

- The foreign company wants to invest into a restricted industry sector, where the law permits foreign investment only via a joint venture with a Chinese partner;
- The foreign investor wants to make use of the sales channels and network of a Chinese partner having local market knowledge and established contacts.
- There are two types of JVs in China, which differ primarily in terms of how profits and losses are distributed.

Equity Joint Venture (EJV):

- Profits and losses are distributed between parties in proportion to their respective equity interests in the EJV
- Generally, the foreign partner should hold at least 25 percent equity interest in the registered capital of the EJV
- Limited liability as a Chinese legal person
- Cooperative Joint Venture (CJV):
- Profits and losses are distributed between parties in accordance with the specific provisions of the CJV contract
- A CJV can be operated either as a limited liability company or as a non-legal person

Wholly foreign-owned V e nterprise (WFOE)

A wholly foreign-owned enterprise (WFOE), the most commonly used foreign investment structure, is a limited liability company wholly-owned by a foreign investor(s).

Unlike an RO, a WFOE can make profits and issue local invoices in RMB to its suppliers. Furthermore, the liabilities of shareholders to a WFOE are limited by the assets they bring to the business. A WFOE can also employ local staff directly, without any obligations to employ the services of an employment agency.

The Foreign Investment Industrial Guidance Catalogue (most recently updated March 10, 2015), divides industries into three categories: those encouraged, restricted and prohibited for foreign investment. Industries not listed in the Catalogue are generally permitted. The catalogue also specifies industries in which foreign investment may only be made as part of a joint venture. Please note that differential rules may apply in certain special areas; for example, in the pilot Shanghai Free Trade Zone, foreign investment is permitted in any industry not specifically prohibited by the Zone's "negative list", allowing for somewhat relaxed rules.

There are three distinct WFOE setups available:

- Service (or Consulting) WFOE;
- Trading WFOE (or Foreign-invested Commercial Enterprise, "FICE"); and
- Manufacturing WFOE.

While all three structures share the same legal identity, they differ significantly in terms of their setup procedures, costs and the range of commercial activities in which they are allowed to engage. Trading WFOEs and Manufacturing WFOEs must derive the majority of their revenue from their namesake business, but can also provide associated services; while Service WFOEs are additionally permitted to conduct trading activities related to their services.

FICE

A foreign-invested commercial enterprise (FICE), which can be set up either as a WFOE or a JV, is a type of company for retail, franchising or distribution operations. A WFOE or JV can be established exclusively as a FICE, or can combine FICE activities with other business activities, such as manufacturing and services.

Generally, a FICE is inexpensive to establish and can be of great assistance to foreign investors by combining sourcing and quality control activities with purchasing and export facilities, thus providing more control and quicker reaction times compared to sourcing exclusively via an overseas headquarters.

FICEs are also the ideal choice for foreign companies that need to source in China in order to resell to its domestic consumer market. Without a Chinese trading company, the alternative would be to buy from overseas, and have the goods shipped out of China before then reselling them back to China (which would mean additional logistical costs, customs duties and value-added tax).

Other options

Two other foreign investment options worth mentioning are foreign-invested partnerships (general partnership or limited partnership) and, less common, foreign-invested joint stock companies (or foreign-invested companies limited by shares).

Foreign-invested partnership

Foreign-invested partnerships have some very real benefits not offered by WFOEs, including allowing for domestic and foreign ownership (both individual and corporate) at the same time, setup without registered capital verification, substantial tax savings (pass thru taxation) and the ability to hire foreigners. A disadvantage of this structure is the unlimited liability of the general partner, although this can be overcome by having the general partner as the foreign corporation that initially registers the partnership so that liability stops with the limited liability of the corporate parent.

Foreign-invested joint stock company

Foreign-invested joint stock companies are similar to typical Western corporations. This structure offers the advantage of shared ownership by Chinese and foreigners, relative freedom to transfer company stocks – unlike WFOEs – and even the ability to go public. However, the corporate governance of a foreign-invested joint stock company is more complicated, and according to the relevant Interim Measures (1995), requires a prohibitively large investment of initial capital.

INVESTMENT-TO-CAPITAL RATIOS			
	Common Purpose(s)	Pros	Cons
Representative Office (RO)	• Market research • Liaise with overseas headquarters	• Easiest foreign investment structure to set up • No registered capital requirement • Paves way for future investment	• Cannot invoice locally in RMB • Must recruit staff from local agency; no more than four foreign employees
Wholly Foreign-owned Enterprise (WFOE)	• Manufacturing • Servicing • Trading (if a FICE)	• Greater freedom in business activities than RO • 100% ownership and management control	• Registered capital requirement • (for select industries) • Lengthy establishment process
Joint Venture (JV)	• Entering industries that by law require a local partner • Leveraging a partner's existing facilities, workforce, sales/ distribution channels	• See common purpose(s)	• Split profits • Less management control than a WFOE • Technology transfer/IP risks • Inheriting partner liabilities
Foreign-invested Partnerships (FIP)	• Investment vehicle • Servicing	• Allows for domestic and foreign ownership • Easier setup (does not require registered capital verification) • Substantial tax savings	• Unlimited liability of the general partner • Newness of structure (potential challenges with taxation or foreign currency exchange)

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HOW DO I ESTABLISH A BUSINESS?

CHET SCHELTEMA
Regional Manager
International Business Advisory
Shanghai Office

"Setting your business up right from the start can save a lot of hassle in the long run. Any changes to your business are likely to take at least another 2-3 months to complete."

When establishing a company in China, it is highly advisable to seek professional assistance to guide you through the complex setup procedure and outline the roles and responsibilities of key positions in your future company. This can be a critical factor in ensuring the success of the venture and avoiding time-consuming changes to the company later on down the line.
In this section, we discuss:

- Corporate establishment
- Key positions in a foreign-invested entity
- Office premise requirements
- Opening a bank account
- Intellectual property

Corporate establishment

Establishing a foreign investment structure in China generally takes between 3 and 6 months and involves the following government authorities:

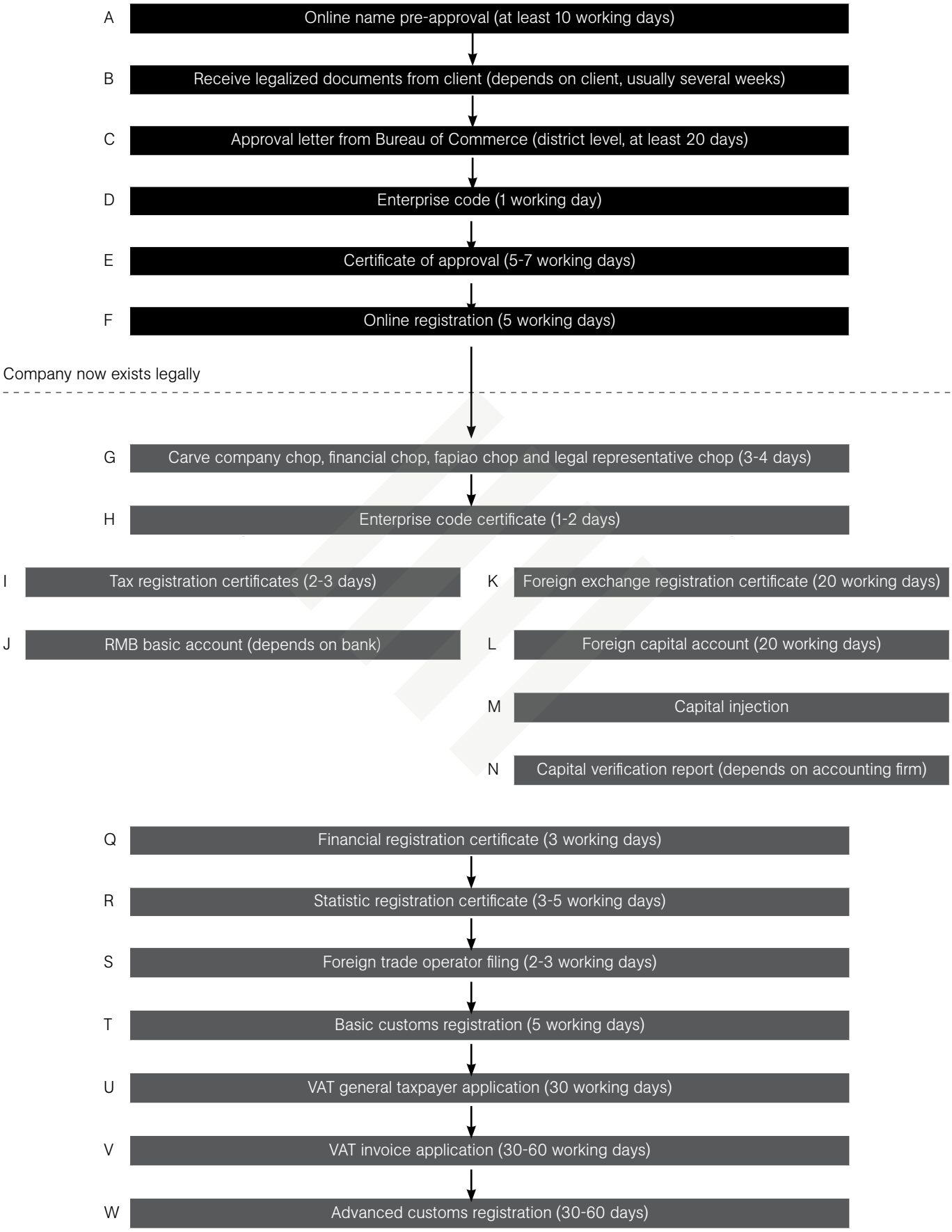
- Ministry of Commerce
- Administration of Industry and Commerce
- State Administration of Foreign Exchange
- State Administration of Taxation
- Customs Office
- Quality and Technical Supervision Bureau
- Statistics Bureau

The establishment process varies based on one's chosen investment structure and planned business scope. For example, Manufacturing WFOEs require an environmental evaluation report be completed, while Trading WFOEs need to undergo customs/commodity inspection registration.

Many companies choose to establish holding companies, or "special purpose vehicles," in jurisdictions such as Hong Kong or Singapore to hold their Chinese entity. Holding companies allow for an additional layer of distance between the Chinese subsidiary and parent company, and can "ring-fence" the investment to an extent, protecting it from the potential risks and liabilities of the Chinese subsidiary.

In the case that an investor wishes to sell his or her Chinese business, or introduce a third-party partner / shareholder into the structure, the administrative changes can also be done at the holding company level, rather than at the China level, where the regulatory environment is tougher and procedures more time-consuming.

WFOE SETUP PROCEDURE



Given the comparatively sophisticated banking systems of Hong Kong and Singapore, establishing a holding company in either jurisdiction is a popular option for foreign companies wishing to hold their China-earned profits offshore. In this way, the profits can be re-invested into China if the need arises, or used to further expand operations elsewhere in Asia. Subject to the parent country's anti-avoidance tax rules, this method is often used as a tax deferral mechanism for foreign companies who do not want to remit their China profits immediately back to the home country.

In addition, Hong Kong and Singapore holding companies present a number of tax advantages, including reduced withholding tax rates on the repatriation of profits and limiting tax exposure on capital gains.

Note that at the time of writing (March 2015), the U.S. Foreign Account Tax Compliance Act (FATCA) has significantly disrupted the ability of U.S. investors to open or maintain bank accounts through Hong Kong, threatening to cut off the cashflow to their mainland China subsidiaries. Although also a signatory to FATCA, Singapore appears to be less affected by these developments.

FABIAN KNOPF
Senior Associate
International Business Advisory
Shenzhen Office

"The legal representative is the person who really carries responsibility for a company in China. You will need to appoint someone who is not just technically competent, but China competent."

Key positions in a foreign-invested entity

The key positions in a foreign-invested entity vary by the investment structure and size, with some overlap.

ROs should designate a chief representative to sign documents on behalf of the company. In addition to a chief representative, an RO can also nominate multiple general representatives.

For WFOEs and JVs, key positions include shareholders, an executive director (or board of directors), supervisor(s), general manager and legal representative.

LEGAL REPRESENTATIVE CANDIDATES		
	WFOE	JV
Executive Director	√	
Chairman of the Board of Directors	√	√
General Manager	√	√

Shareholders and executive director (or board of directors)

For a WFOE, the shareholder(s) represents the highest authority of the company, whose decisions regarding company operations are executed by the executive director or board of directors.
For a JV, the board of directors is the highest authority. The board should have no fewer than three directors appointed by the parties to the JV, with the ratio between Chinese and foreign-appointed directors determined through mutual consultation.

Supervisor(s)

WFOEs and JVs must also have at least one supervisor to oversee the execution of company duties by the director(s) and senior management personnel. To ensure there are no conflicts of interest, a company's director(s) and/or senior management personnel cannot concurrently serve as supervisors. Where a company has a relatively small number of shareholders and is relatively small in scale, one or two supervisors will suffice. For larger companies, a board of supervisors composed of no less than three members is required.

General manager

Both WFOEs and JVs need a general manager who is responsible for day-to-day company operations. This position may be concurrently filled by the executive director or a member of the board of directors. For JVs, several deputy general managers can also be appointed; this group is collectively referred to as the management office.

A director of the board can concurrently hold the post of general manager, deputy general manager, or any other senior management position, which includes CFO or any other position designated as such in the company's Articles of Association.

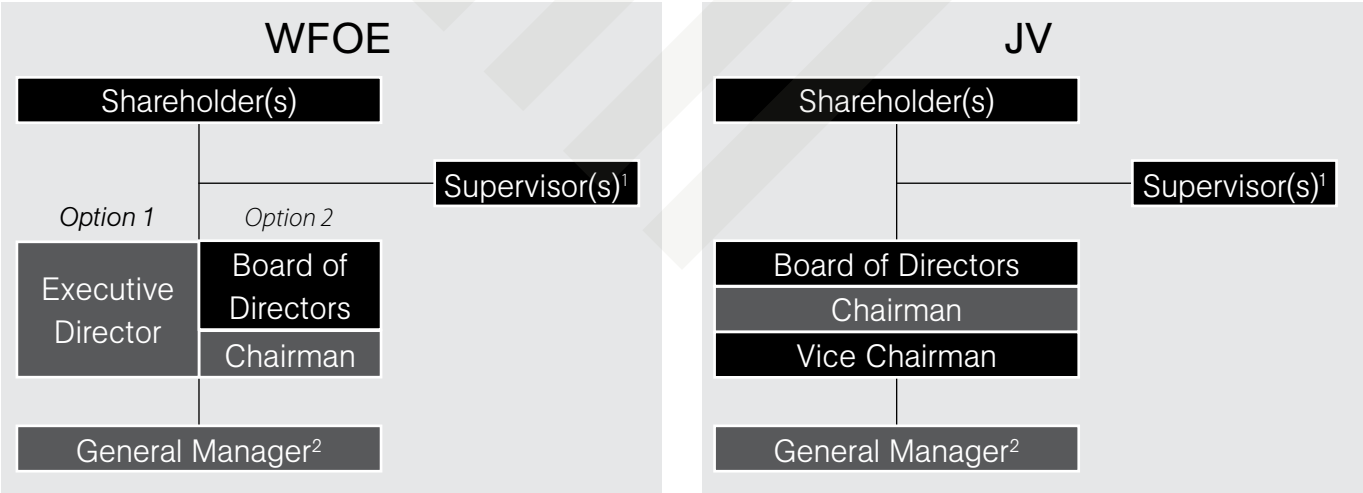
Legal representative

Every business established in China, foreign or domestic, is required to designate a legal representative, i.e. the person responsible for performing the duties and powers on behalf of a company. The legal representative is, by definition of his or her role, one of the most powerful people in a foreign-invested entity. Yet this power comes with heavy responsibility, and if a single individual in a foreign-invested entity is to be held accountable for company actions, that person is more likely than not the legal representative.

Eligibility for the role of legal representative varies by FIE type, as shown in the accompanying table.

KEY POSITIONS IN WFOE AND JVS

■ Legal Representative Candidate



1. *A supervisor or member of the board of supervisors cannot be a director or among senior management personnel. Larger companies require a board of supervisors composed of representatives for both shareholders and staff.*
2. *The general manager can also be a director or executive director. For JVs, in addition to the general manager, several deputy general managers can also be appointed, collectively referred to as the "management office."*

Office premise requirements

To register a foreign-invested entity (FIE) in China, it is a prerequisite to own or lease an office premise (as the primary place of business), and register this with the State Administration of Industry and Commerce (SAIC). Doing so requires that the FIE possess all legal documents pertaining to the premise as required by the Chinese authorities. Only one business may be registered per office unit. Many new entrants to the China market find success using serviced offices offered by any number of providers in major cities across China.

Wholly Foreign-Owned Enterprise

When registering a WFOE, if the intended office premise is owned by the same individual or entity applying for business registration, the applicant needs to show a Certificate of Premise Ownership (CPO) issued by the real estate authority and submit a copy of this to the local AIC. Most CPOs explicitly indicate the purpose of the premise; the AIC does not accept "residential" CPOs to be used as the basis of a business registration.

If the office premise is leased from another individual or organization, the applicant is required to produce the original lease agreement with a minimum one-year lease term, as well as a copy of the CPO of the property. The landlord should be an AIC registered business. Usually, a copy of the landlord company's business license is also required, including the company's official chop.

In addition, both parties to the lease agreement should complete lease registration and record-filing procedures with the local real estate authority within 30 days following the agreement's conclusion. Upon confirmation that the lease is legitimate, the authority will issue a Housing Lease Certificate, which legally allows the property to be used for manufacturing or business operations.

If a CPO cannot be produced for AIC registration due to a legitimate reason, a certificate issued by the local real estate administration authority, sub-district office, neighborhood committee, or the administrative institution of a development zone will be required to prove the legitimate ownership of the property by the applicant or landlord.

Foreign-Invested Commercial Enterprise

In addition to completing the checklist of office premise requirements for WFOEs, foreign-invested commercial enterprises (FICEs) engaged in retail activities need to undergo additional legal procedures for opening a retail shop in China.

China's Administrative Measures for Foreign-invested Commercial Enterprises stipulates that foreign investors applying to open a retail shop as part of establishing a FICE should be in compliance with the relevant development plan of the city. This generally requires the foreign investor to obtain approval documents from their local office of the Ministry of Commerce (MOFCOM) before being able to complete business registration with the AIC.

If a pre-established FICE intends to set up a shop, apart from obtaining approval from the local MOFCOM, the FICE must also have passed its mandatory annual inspection, conducted jointly by If a pre-established FICE intends to set up a shop, apart from obtaining approval from the local MOFCOM, the FICE must also have passed its mandatory annual inspection, conducted jointly by several government departments including the AIC, local tax bureau, and local MOFCOM. Its registered capital must have been paid in full as well.

In either scenario for the establishment of a retail shop, the land use rights certificate and/or lease agreement for the premise of the shop are usually required to be presented to the authorities.

Representative Office

Registration of representative office (RO) requires the relevant lease agreement and a copy of the CPO. Representative offices require special attention when choosing a suitable premise for AIC registration. Because an RO is technically not a Chinese enterprise but an extended arm of the overseas parent company in China, the local AIC may scrutinize the registered office premise more closely, and/or impose special requirements for its registration. Detailed rules vary by region.

For example, in Shanghai, the local AIC previously required that an RO could only be registered at a commercial office premise with the approval from the Public Security Bureau (PSB) to house ROs. While this requirement is no longer mandatory, the registered office of an RO still needs to be designated for non-residential purposes, else it risks being denied for registration by the AIC.

Opening a bank account

Account types

Foreign-invested entities in China need to establish at minimum two bank accounts: a RMB basic account and a foreign currency capital contribution account.

RMB basic account:

An FIE must have one (and only one) RMB basic account for daily business operations in China. This account is the only account from which the company can withdraw RMB cash. The RMB basic account often acts as a designated account for making tax payments.

Foreign currency capital contribution account:

An FIE must also have a foreign currency capital contribution account to receive capital injections from the foreign investor. Approval to open this account can be obtained from the State Administration of Foreign Exchange ("SAFE").

Additional general RMB accounts and other types of foreign currency accounts can be opened for different purposes. For foreign currency accounts, these may include a settlement account for the collection of current items in a foreign currency, foreign debt special accounts and temporary capital accounts.

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International and Chinese banks

Foreign investors can establish the above accounts in China with international banks with a local presence, the major banks being Bank of East Asia, Citibank, DBS Bank, Hang Seng Bank, HSBC and Standard Chartered; or through a Chinese bank, the largest being Industrial and Commercial Bank of China, Bank of China, China Construction Bank, Agricultural Bank of China, and Bank of Communications.

Foreign investors in China often prefer to establish an account with an international bank because of an existing business relationship. However, establishing accounts with a Chinese bank has a number of advantages, namely:

- The application process for opening a bank account with an international bank in China will be more document-intensive and take longer compared to opening such an account at a Chinese bank.
- There are substantially more Chinese commercial banks than foreign bank branches, which allows for more convenient and faster RMB remittance.
- Most Chinese companies have local bank accounts. Conducting transactions with them will be easier and faster if done from a Chinese bank instead of an international bank.
- Bank account security

When opening a bank account in China, an FIE will need to specify what will act as the "signature" of the company. Usually the company's financial chop (seal) is required to do so, along with either the legal representative's chop (or chief representative's chop for an RO) and a handwritten signature. Banks generally prefer using the legal representative's chop instead of a handwritten signature, as the latter is easier to forge and harder to verify.

Many bank transactions can now be done online in English, including the approval of transactions and viewing account balances from abroad. It is possible and sometimes necessary to make tax payments online in certain areas (including Beijing) by signing a three-party agreement with an authorized Chinese bank.

For an entity's RMB basic account, it is possible to apply for different levels of e-banking access and multiple security keys (in the form of a key-ring/USB dongle) – one with access rights and another with approval rights. Another common security measure is a device that generates a new password for every check that is written.

Intellectual property considerations

Many FIEs in China have graduated from a manufacturing focus to a model where their real business value is now bound up in their intellectual property. Unfortunately, intellectual property rights (IPR) violations continue to pose a problem in the country, including via the infringement of copyrights, trademarks, patents, and designs.

These types of IPR must be registered with the appropriate Chinese agencies and authorities to be enforceable in China. In practice, most FIEs adopt measures to proactively search the Internet for all known kinds of violation, in addition to sending staff to corporate functions and trade-fairs. Companies can also pay RMB 800 to Chinese customs to have them monitor their trademarks and contact them if any violation is discovered.

Copyrights

Strictly speaking, copyrighted works do not require registration for protection. Nonetheless, companies should consider registering their works with the National Copyright Administration, since this provides evidence of ownership, which may be needed in the event of legal action.

Patents

Patents are territorial rights, meaning that a patent in another country has no effect in China. Companies should file applications for both their core and fringe technologies and make sure that their patents are properly translated into Chinese.

China follows a "first-to-file" system for patents, which means patents are granted to whoever files first, even if they are not the original inventors. A foreign patent application filed by a person or firm without a commercial office in China must be conducted through an authorized patent agent. Patents are filed with the State Intellectual Property Office in Beijing.

Trademarks

China has a "first-to-register" system for trademarks, meaning that the first party to file for the registration of a particular trademark will be granted the rights. Companies should register their brands' English and Chinese names, as well as any marks and/or logos with the Trademark Office. Careful attention should be paid to the product categories and sub-categories selected for filing (separate registration is required for each category under which protection is sought), and to check whether similar trademarks have already been filed.

Application to register a trademark should be made with the Trademark Office of the State Administration for Industry and Commerce in Beijing, and costs RMB 800. However, foreign companies are required to entrust a trademark agency to handle the registration, which means an additional agency charge ranging from RMB 500 to RMB 1,000. A list of trademark agencies can be found at *http://www.saic.gov.cn/*. The Trademark Office will complete examination of the application within nine months from the date of receipt of the required documents.

HOW DO I MAKE CHANGES TO MY BUSINESS?

RICCARDO BENUSSI
Associate
International Business Advisory
Shanghai Office

Making changes to a Chinese entity after establishment – such as to its range of commercial activities or registered address – can be a challenging, time-consuming and expensive procedure. In some cases, closing the entity all together and starting from scratch may be easier, or even mandatory. For these reasons, it is always better to start out with a clear and informed business plan, rather than attempt to make on-the-fly adjustments later on.

In this section, we discuss:

- Company name
- Business scope
- Registered capital
- Shareholder structure
- "RO-WFOE conversion"
- Relocation

"China has a "first-to-register" system for trademarks, meaning that the first party to file for the registration of a particular trademark will be granted the rights."

Company name[1]

The procedure for changing the name of a company in China is quite complex, albeit far simpler, for example, than changing one's business scope. Because a company's name is displayed on several types of official documents (such as its business license, company chop and tax registration certificate), any changes to this information must be filed with each respective governing authority. It is crucial that companies duly prepare for each step in the process prior to filing an initial application, as deadlines at later steps take effect upon the completion of earlier ones.

Step 1 - The name change must be filed with the local Administration for Industry and Commerce (AIC) at which the company was originally registered.
Step 2 - The company must file an application with its original AIC body of registration for a change of information on its business license. The application to do so must be submitted within 30 days of the change in company registered information as completed in Step 1.
Step 3 - After the name change has been registered with the AIC for both the company (Step 1) and its business license (Step 2), the company must then go about updating other documents on which its name appears, including various types of chops (Financial Chop, Company Chop, Customs Declaration Chop, etc.), which must be newly carved and registered with the company's local Public Security Bureau. Moreover, the company will have to make changes to all ongoing contracts with suppliers and clients.

1. See more at: http://www.china-briefing.com/news/2014/06/25/whats-name-changing-name-company-china.html#sthash.dmmsQMIO.dpuf

Business scope[2]

Changing the business scope of a company in China is a lengthy process, involving the majority of government authorities involved in the original corporate establishment process. If approved, such a change will take a minimum of two months to complete.

Generally, when an enterprise intends to change its business scope, it must first submit its amended Articles of Association and a Board Resolution (or Shareholder Resolution), among other documents, to the relevant approving authority. Following the issuance of an approval certificate, the modified business scope must be filed with the Administration for Industry and Commerce within 30 days. Subsequently, the company's tax certificate, financial certificate and foreign exchange registration certificate, among other documents, must be changed.

If the new business scope diverges significantly from the original business of the company, the company name should be changed as well, since this must generally reflect the main business of the company. Application for a new name should be undertaken with the local Administration for Industry and Commerce (as in 1.3.1 above) prior to applying for approval to change the business scope.

Registered capital

Companies adjust their registered capital for one of three types of reasons - financial, strategic or regulatory. Because increases are far more common than decreases, we shall only discuss the former here. Similar to changing a company's business scope, increasing registered capital is a time-consuming process that involves working with most of the government authorities involved in the entity's initial setup.

Step 1 - The company must provide a reasonable explanation for the increase in registered capital to MOFCOM and obtain its approval.
Step 2 - The company should file an initial application with the original AIC of registration within 30 days of the decision to increase registered capital. If the increase is more than 20 percent of the original registered capital, the funds must be verified by a legally authorized audit or accounting firm.
Step 3 - The company must apply to the original AIC of registration for a new business license.
Step 4 - The company should transfer the additional capital directly into its capital account. The company will be charged a fee for the increase of registered capital, which varies according to the chart below.

SCHEDULE OF FEES	
Registered Capital (RMB)	Fee
10 million or less	0.08 percent of the increase
10 million - 100 million	0.04 percent of the increase
100 billion or above	Zero

2. More information: http://www.china-briefing.com/news/2014/07/18/new-line-work-changing-business-scope-company-china.html

Shareholder structure

A company typically decides to make changes to its shareholder structure upon the entrance of a new shareholder who is to receive an equity transfer from one or more existing shareholders. Alternatively, it may be necessary to revise the shareholder structure as the result of equity transfers between shareholders or the exit of a shareholder from the company.

Though information on company shareholders is not explicitly listed on a Chinese business license, in most cases, the company will still need to apply for a new business license, considerably complicating the overall application process.

Step 1 - An equity transfer agreement should be signed between the transferor and the new shareholder. The company must issue a capital contribution certificate for the new shareholder (if applicable) and revise the list of shareholders.
Step 2 - The equity transferor or transferee (the taxpayer) shall file with the competent tax authorities and obtain a tax payment certificate for individual income tax or a tax exemption certificate.
Step 3 - The company must apply to the original AIC of registration for a change of company shareholders and obtain a "Notice of Acceptance."

Furthermore, the company will also need to file with relevant departments such as Customs, the State Administration of Foreign Exchange (SAFE) and the local Ministry of Commerce. As with other changes to company registered information, its business license and tax registration certificate will need to be updated as well.

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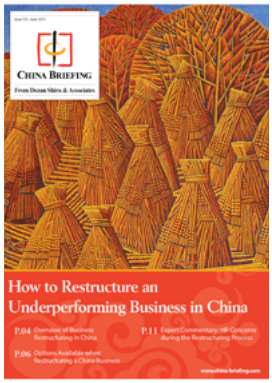

How To Restructure an Underperforming Business in China
June, 2015

In this issue of China Briefing magazine, we explore the options that are available to foreign firms looking to restructure their operations in China.
- See more ***here***

"RO-WFOE conversion"

Multinational companies operating in China through a representative office (RO) occasionally encounter the need to convert their existing operations (unable to engage in profit-making commercial activities) to a wholly foreign-owned enterprise (WFOE). In fact the act of "converting" an RO to a WFOE is a misnomer; rather, deregistering an RO and establishing a new WFOE are two separate procedures that must be done in sequence. As an RO is not a legal personality, the term "deregistration" is used instead of "liquidation," though the two processes share many similarities.

Step 1 - Prior to actual deregistration, the RO must apply to both its local tax bureau and the State Administration of Taxation for tax audit and tax deregistration. To do so, the RO must first undergo an audit by a local Chinese CTA firm for taxes owing from the past three years.

Once the audit is completed, the enterprise should submit to the tax bureau a board resolution affixed with the signature and seal of the chairman of the board of directors, as well as a cancellation application signed by the chief representative of the RO.

Should any unpaid taxes or other irregularities be found by the tax authorities at any point during this process, the RO may be required to submit additional documentation, pay penalties, or settle unpaid taxes with the authorities.

Step 2 - The enterprise should close its bank account. Unissued checks and deposit slips will need to be returned to the bank and any funds remaining in the account should be transferred out. If the RO intends to transfer the account to its parent company, it will be required to provide reasoning for such actions and seek approval from the bank.

Step 3 - The enterprise can then proceed to deregister with its local Administration of Industry and Commerce (AIC), where its application will be processed within 10 workdays of receipt. If successful, the enterprise will be issued a "Notice of Deregistration" and all the registration certificates will be cancelled, as well as the chief representative's working card. Announcement of the RO's deregistration must be listed in a media outlet designated by the AIC. The RO's business registration and office lease must be valid up until the official notification of deregistration has been issued by the AIC.

Step 4 - Notification of the RO's deregistration should then be filed with various other authorities, including the State Administration of Foreign Exchange (SAFE), Customs, Quality and Technical Supervision Bureau, Public Security Bureau and Statistics Bureau.

The total time required for deregistration is typically three to six months (depending on the region), but can take over a year in cases containing irregularities, particularly in the tax deregistration phase. Fortunately, the new WFOE can be established according to the procedure outlined above (in 1.1.1) while the RO deregistration process is underway.

KYLE FREEMAN
Associate
International Business Advisory
Beijing Office

"While the steps for deregistering an RO are few, the difficulty of tax deregistration should not be underestimated."

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Relocation

Where possible, relocation to a new business address should be avoided to prevent the loss of time and money necessarily incurred. Relocating within a tax district is a relatively simple process, but cross-district relocations are significantly more involved, requiring several months to complete.

The challenges involved in relocation are largely related to taxation, which is decentralized in China. Taxes are managed directly by local tax bureaus, and transferring to a new tax district requires the foreign investor to actively coordinate between bureaus in both districts. These are often in competition with each other and no tax officer wants to lose out on revenue by allowing a lucrative company to relocate to another tax district.

If relocation is not possible, or to avoid interruptions in business operations, establishing an entirely new company and then closing the old company represents the "default" option for relocation. Opening a branch office in the desired location is also a possibility. Branches are easier to set up and maintain, but limited in many ways, such as not being able to expand beyond their parent company's business scope.

BRANCH OFFICE (BO)		
Common Purpose(s)	Pros	Cons
• Geographic expansion • Alternative to relocation	• Simple establishment • No registered capital requirement • Easy maintenance (only branches wishing to invoice must declare taxable items from locally produced invoices)	• Limited business scope (must be within that of the parent; cannot import or export) • Not a legal entity (all liabilities born by the parent company) •

For experienced advice on Corporate Formation from our seasoned specialists, please email *china@dezshira.com*

02/03

TAX, AUDIT AND ACCOUNTING

- What are the major taxes of China?
- What are some of the key compliance requirements?

WHAT ARE THE MAJOR TAXES OF CHINA?

Income taxes

Corporate income tax (CIT)

Corporate income tax (CIT) is calculated against the company's net income in a financial year after deducting reasonable business costs and losses - in other words it is effectively a tax on profits. CIT in China is settled on an annual basis but is often paid quarterly with adjustments either refunded or carried forward to the next year. The final calculation is based on a company's year-end audit.

China's revised Corporate Income Tax Law, which took effect in 2008, unified the tax rates for foreign and domestic enterprises. The income tax rate applied to all companies in China today, both foreign and domestic, is 25 percent. Meanwhile, small and low-profit enterprises are entitled to a reduced CIT rate of 20 percent, and if a taxpayer qualifies as a high-tech enterprise, a reduced CIT rate of 15 percent applies.

Individual income tax (IIT)

In accordance with the Individual Income Tax Law of the PRC, IIT is imposed on all individuals, including Chinese and foreign nationals, residing in or deriving income from China. PRC residents are generally subject to tax on their worldwide income, while non-residents are taxed on their PRC-sourced income only.

IIT is imposed on income from wages and salaries at progressive rates ranging from 5 to 45 percent; on capital gains at a flat 20 percent rate; and on interest, dividends and royalties at a flat 20 percent rate. IIT on wages and salaries is normally withheld by the employer and paid to the tax authorities on a monthly basis.

INDIVIDUAL INCOME TAX RATES AND DEDUCTIONS

Monthly Taxable Income (RMB)	Tax Rate	Deduction (RMB)
1,500 or less	3%	0
1,500 < TI ≤ 4,500	10%	105
4,500 < TI ≤ 9,000	20%	555
9,000 < TI ≤ 35,000	25%	1,005
35,000 < TI ≤ 55,000	30%	2,755
55,000 < TI ≤ 80,000	35%	5,505
> 80,000	45%	13,505

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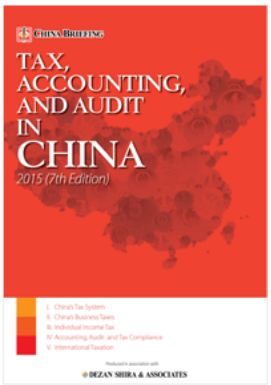


Tax, Accounting, And Audit in China 2015 (7th Edition)
December, 2014

A comprehensive overview of the major taxes foreign investors are likely to encounter when establishing or operating a business in China, as well as other tax-relevant obligations. This concise, detailed, yet pragmatic guide is ideal for CFOs, compliance officers and heads of accounting who must navigate the complex tax and accounting landscape in China in order to effectively manage and strategically plan their China operations.
- See more ***here***

Monthly taxable income is calculated after a standard monthly deduction of RMB 3,500 for local employees. For foreign individuals working in China (including residents of Hong Kong, Taiwan and Macau), the standard monthly deduction is RMB 4,800. Money paid into Chinese social insurance and certain allowances can also be added to the pre-tax deduction.

To determine whether a foreign individual working in China is subject to Chinese tax, it is necessary to look at how much time he or she has spent in China, the source of his or her income, and where the employer is based.

Taxpayer Status	Taxable Income
Living in China ≤ 90 days (183 days if there is a tax treaty in place)	• Income sourced within China • Income paid by overseas employer (not borne by its Chinese operation) is exempt
Living in China > 90 days (183 days if there is a tax treaty) but less than one year	• Income sourced within China • Income sourced outside of China is not subject to IIT, unless the taxpayer is a director or senior manager of a Chinese domestic enterprise
Living in China between one and five years	• Income sourced within China • Income sourced outside of China paid by a Chinese enterprise or individual
Living in China ≥ five years*	• Income sourced within and outside China from the sixth year onwards for every full year spent in China

Income sourced within/outside of China: This is determined by the individual's actual working period within China, regardless of whether the employer paying the income is based in China or not.

One-year test: Individuals who have resided in China for 365 days in a calendar year are deemed to have lived in China for one full year. If an individual leaves China for more than 30 days in a single trip or for more than 90 days cumulatively over multiple trips during the calendar year, that time is not counted towards the individual's stay in China.

Five-year test: An individual who has stayed in China for five consecutive years must begin to pay individual income tax on worldwide income beginning in the sixth year. Years are counted in the same way as with the One-year Test, so if the individual leaves China for more than 30 days in a single trip, or for more than 90 days cumulatively over multiple trips during the calendar year, that time will not be counted towards the individual's stay in China.

This means an individual can avoid being liable to tax on worldwide income that year by taking a one-off 30+ day leave from China, or be outside of China for over 90 days.

*Note: an individual can res et the five year count only if he or she has resided **less than 90 days** in China during the year.*

Turnover taxes

Business tax (BT)

Business tax (BT) is a turnover tax levied on goods and services at rates ranging from 3 to 20 percent, depending on the industry. In order to avoid double taxation and support its modern service industry, China launched a pilot program in 2012 replacing BT with value-added tax (VAT) for select industries, which was subsequently expanded nationwide in mid-2013. By 2015, the State Administration of Taxation (SAT) and the Ministry of Finance (MOF) aim to complete the nationwide transition from BT to VAT.

To date, the following industries remain subject to BT:

Industry	Industry
Construction	3%
Banking and Insurance	5%
Cultural and Sports Services	3%
Entertainment	5%-20%
Services	5%

Note that BT applies to services performed where either the service provider or the service recipient is located in China, without regard to where the service is actually being rendered. BT is usually calculated, filed and paid to the local tax bureau every month.

Value added tax (VAT)

Value-added tax is considered a neutral tax, allowing businesses to offset VAT incurred in relevant purchases from their VAT liability. Conversely, BT is levied on gross turnover with no deduction permitted for tax paid when purchasing other goods or services. The two taxes are generally not mutually deductible.

At the time of writing, enterprises and individuals engaged in the following commercial activities are subject to VAT:

FOR MORE INFORMATION
Tax & Accounting News Section
China Briefing

VAT REFORM RATES		
Taxpayer Type	Taxable Item	Tax Rate
General taxpayer	Leasing services of tangible property	17%
	Transportation services: • Overland transportation services • Sea transportation services • Air transportation services • Pipeline transportation services	11%
	Modern services: • Research & development and technical services • Information technology services • Cultural/creative services • Logistics auxiliary services • Authentication and consulting services	6%
	• Taxable services stipulated by the Ministry of Finance and the State Administration of Taxation	0
Small-scale taxpayer	• Taxable services switching from business tax to VAT	3%
General taxpayer & small-scale taxpayer	• International transportation services, and R&D services and design services provided to overseas entities by entities and individuals within the territory of the People's Republic of China • Space transportation services • Transport services to and from Hong Kong, Macau and Taiwan and transport services provided in Hong Kong, Macau and Taiwan by entities and individuals in China • Charter services in which the vehicles chartered are used for international transport services or to and from Hong Kong, Macau or Taiwan	0

VAT taxpayers are divided into small-scale taxpayers and general taxpayers, with only the latter able to issue fapiaos - a key requirement for conducting business with many Chinese suppliers and clients (see the pop-out box below). Small-scale taxpayers are subject to a lower uniform VAT rate of three percent, as compared to rates ranging from six to17 percent for general taxpayers, but they cannot credit input VAT from output VAT, nor are they entitled to VAT export exemptions and refunds. The current VAT rate for small-scale taxpayers is 3 percent.

Fapiao

In China, invoices (or "fapiao" in Chinese) are more than just ordinary receipts - they are also the way in which the government monitors the tax paid on any transaction. Fapiao are printed, distributed, and administrated by tax authorities, and taxpayers are required to purchase the invoices they need from the tax authorities according to their business scope.

Fapiao can mainly be sorted into two categories – general invoices and special value-added tax (VAT) invoices. Although these terms are often used interchangeably, there are notable differences between the two, including applicability for tax deductions, detail of information recorded, and usage by different types of taxpayers. It is therefore important to check with your accountant with regard to which type of invoice is needed according to the intended purpose.

Consumption tax (CT)

Consumption tax applies whenever certain luxury or other goods are manufactured, processed or imported. Tax rates vary considerably depending on the product, for example, a rate of 36 percent is imposed against cigars, and 3 percent on motor vehicle tires. The tax paid is generally computed directly as a cost and cannot be refunded. If a company undertakes processing of taxable goods in service of another party, the processor is liable to withhold and pay consumption tax based on the value of the raw materials and processing fees. Consumption tax should be filed and paid monthly.

Other taxes

Stamp tax

Stamp tax is levied on contracts with regard to purchases and sales, processing, construction and engineering projects, asset leasing, goods transportation, storage and warehousing, loans, asset insurance, technology contracts, property rights transfers, accounting ledgers and royalty licensing. The tax rates vary between 0.005 percent and 0.1 percent.

Surcharges

Foreign-invested enterprises, foreign enterprises and foreign individuals who are subject to VAT, CT or BT are also subject to urban construction and maintenance taxes (UCMT), education surcharge (ES) and local education surcharge (LES).

- UCMT rates are 7 percent for urban areas, 5 percent for counties (towns), and 1 percent for other regions
- ES rate is 3 percent regardless of location
- LES rate is 2 percent regardless of location
- Together these surcharges amount to 12 percent of a company's total turnover tax liability (i.e., VAT, CT and BT) in urban areas.

Property tax

All owners, mortgagees, custodians and users of property for commercial purposes must pay real estate tax. This does not include residential property for self-use, but does include residential properties for lease. The applicable tax rate is 1.2 percent, calculated on the residual value minus between 10 percent and 30 percent of the original value of the property (as determined by the local government).

Customs duties

Customs duties, or tariffs, are divided between differential rates for imports and exports. Import duty rates fall into two categories - general tariff rates and preferential tariff rates. The former apply to imports originating in countries with whom China has not concluded a "most favored nation (MFN)" trade agreement, while preferential tariff rates apply to goods originating in such signatory countries. Customs duties are calculated either on an ad valorem basis (based on value) by applying an applicable rate, or on a quantity basis by applying an amount of duty per unit.

WHAT ARE SOME OF THE KEY COMPLIANCE REQUIREMENTS?

SISI XU
Senior Manager
Corporate Accounting Services
Shenzhen Office

"Making changes to your business can be complex and time consuming, so it is strongly recommended to plan ahead and utilize the most tax efficient structure from the start."

Accounting and bookkeeping

All FIEs in China are required to prepare annual financial statements, including balance sheets and income statements for their annual audit (conducted by a CPA registered in China). China's basic accounting standards, issued by the Ministry of Finance in 2006 and partly revised in 2014, are broadly in line with the International Financial Reporting Standards.

The renminbi (RMB) is the base currency for ledgers and financial reports. For enterprises using currencies other than RMB in their business transactions, foreign currencies can be used as the bookkeeping base currency; however, financial reports are required to be shown in RMB. Furthermore, accounting records must be maintained in Chinese. FIEs can choose to use only Chinese or a combination of Chinese and a foreign language.

Enterprises in China should adopt the accrual basis of accounting in performing recognition, measurement and reporting for accounting purposes. FIEs, including their legally responsible persons, must take full responsibility for the truthfulness, legitimacy and completeness of financial statements. These statements will be used for computing the FIEs taxable and distributable profit. Books and records have to be retained for at least 15 years under Chinese law.

By law, any business transactions carried out in mainland China require a fapiao (see page _ above). In practice, a significant portion of small to medium-sized companies conduct certain sales under the table out of reluctance to part with their fapiao, since for each fapiao issued, tax will be payable on the profit from the transaction. For purchasing goods and services, receiving fapiao from the seller is essential for claiming VAT refunds and lowering one's tax liability.

Annual compliance

In advance of being able to distribute and repatriate profits, FIEs must complete annual compliance procedures, involving three steps: audit, tax filing and annual license inspection and renewal. These procedures are not only required by law, but are also a good opportunity to conduct an internal financial health check. The relevant procedures and key considerations vary slightly by region and entity type.

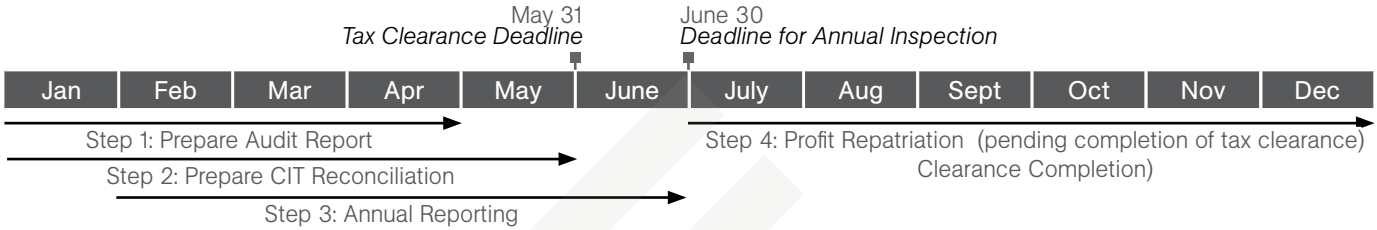
First, several types of audits must be conducted, as based on local requirements. These may include a financial audit, foreign exchange audit and tax verification audit. Second, all FIEs need to submit an annual taxation reporting package to the tax bureau by the end of May each year. This reporting package verifies all taxes payable, including CIT, VAT, BT, consumption tax and other taxes on the basis of the audit results.

Should the audited tax figure be lower than the figure paid, the FIE will need to apply for a tax adjustment for the fiscal year in question. Should the audited tax figure be higher than the paid tax, the FIE will need to pay the balance due to the tax bureau upon submitting the report.

Next, annual license inspection and renewal (or "annual cooperative examination") must be jointly conducted with all relevant government departments, including the local office of the Ministry of Commerce, Finance Bureau, Administration of Industry and Commerce, Tax Bureau, Customs, State Administration of Foreign Exchange and Statistics Bureau to ensure the FIE operates within legal requirements.

Third, following inspection, the FIE shall submit a signed annual cooperative examination report and other prescribed financial information, including the report, the audited financial statements and other materials (all signed and stamped), to the governing administrative body by the end of June.

ANNUAL COMPLIANCE TIMELINE **Subject to regional variation*



Following the annual audit and completion of tax payment, a net profit figure can be derived. The decision to repatriate and/or reinvest profit will depend on the current situation of the China-side FIE and its parent company abroad.

However, not all profit can be repatriated or reinvested. A portion of the profit (at least 10 percent for WFOEs) must be placed in a reserve fund account, treated as part of owner's equity on the balance sheet. This account is capped when the amount of reserve funds equals 50 percent of the registered capital of the company. In addition, the investor may choose to allocate some of the remainder to a staff bonus welfare fund or an expansion fund, although these are not mandatory for WFOEs.
The remaining net profit is available for redistribution. Following a resolution of the board of directors, an application form for the repatriation of funds can be submitted to the tax bureau to authorize the bank to disperse funds.

Due diligence

Broadly speaking, due diligence is a thorough review of a company so as to uncover any fraud, non-compliance or other issues posing a risk to potential partners. Due diligence procedures, which can vary widely based on the intended business transaction and industry of the companies involved, are often split into legal, financial and operational due diligence. A due diligence checklist in China is generally quite similar to those used elsewhere, likely including review of:

- Legal documents for company establishment and any additional government approvals and licenses
- Financial documents, including annual audits, tax returns, current financial statements and loans
- Documentation for real estate and land use rights (in China, land is owned by the state; an individual can merely purchase land use rights)
- Documentation for intellectual property and hard assets
- Major contracts, distribution records, etc.
- Litigation history and outstanding litigation (if any)
- HR administration documents

One of the key differentiating aspects of due diligence in China is the variety of issues commonly discovered in accounting books, from a company completely misrepresenting its financial situation to minor accounting errors that may come from a misguided actions to help the company (i.e. by avoiding tax) or lack of knowledge. Some very common points to pay attention to in financial due diligence investigations in China include:

• Two or more sets of financial accounts:
Many companies keep two or more sets of financial accounts so as to avoid tax, but this practice can also be used to cover up inappropriate financial behavior.
• Revenue received "off the books":
Underreporting of accounts receivable is often used to hide sales and reduce taxable income.
• Employees paid "off the books":
Employees are sometimes paid "off the books" so as to increase expenses and avoid paying taxes on labor salaries. This can result in high liabilities related to IIT and social security.
• Phantom assets and contracts:
The assets list on the books are often an overstatement or understatement of assets actually held. Assets are sometimes "mixed" with those of shareholders.

Depending on the seriousness of infractions discovered in the course of an investigation (if any), it may be necessary to reevaluate one's dealings with the subject company.

JENNY LIAO
Senior Manager,
Corporate Accounting
Services
Shanghai Office

"Not all profit can be repatriated or reinvested. A portion of the profit (at least 10 percent for WFOEs) must be placed in a reserve fund account."

Internal control and audit

Strong internal control systems and periodic audits are essential to preventing fraud when running a company in China. The following is a list of common types of fraud in China-based enterprises (including foreign-invested entities with less than adequate internal control systems), separated by department:

Payroll

- Discrepancy between contract salary and payroll payments
- Deliberate over-accrual/unauthorized use of welfare benefits
- Ghost employees (non-existent employees, whose salary is often sent to the bank account of another employee)

Supply Chain

- Purchasing of overpriced raw materials due to relationship/inappropriate agreement between staff and supplier
- Improper disposal of scrap
- Fake VAT invoices
- Poor inventory control

Sales

- Sale of goods at/below cost due to relationship/inappropriate agreement between sales staff and purchaser
- Payment of unauthorized sales commissions to employees or friends
- Lack of competitive bidding process

A key aspect of the Chinese legal environment is the use of official company seals, or "chops," to legally authorize documentation (often in place of a signature). Because of the opportunities for fraud thus entailed, chops should not all be held by one person and steps should be taken to ensure that chops are not misused.

Depending on its business scope, a company may hold any number of chops, all for a different purpose and used on different types of official documentation, including a company chop, financial chop, contract chop, customs chop, invoice chop, etc.

An internal audit ordered directly by company headquarters is the best way to evaluate the effectiveness of internal control systems and prevent fraud in a China-based entity. An internal audit engaged by the China-based entity and reporting only to that entity runs the risk that fraud discovered at the local level may not be reported to the overseas headquarters.

HANNAH FENG
Senior Manager
Corporate Accounting Services
Beijing Office

"We typically recommend one of two types of assurance to our clients: a 'health check' or a 'full scope.' In a health check, we run through a general internal control checklist and try to gauge whether an organization is under control risk"

Transfer pricing

Credit: Sowmya Varadharajan, ICAdvisors

Transfer pricing concerns the prices charged between associated enterprises established in different tax jurisdictions for their intercompany transactions. Specifically, any Chinese taxpayer engaged in related party transactions with other group entities is required to demonstrate that such transactions are conducted in a manner consistent with the "arm's length standard" – under which taxpayers should be able to demonstrate that they transact with related parties in a similar manner, under comparable conditions as they would with third parties.

The relationship threshold for transfer pricing rules to apply between parties is low in China compared to other countries. All transactions between the HQ and its China-side entity should be conducted based on the arm's length principle, as the two are related parties according to Chinese tax laws.

From a transfer pricing perspective, taxpayers operating in China have to be aware of their tax filing obligations. This consists of two parts: (a) ensuring that related party transactions are appropriately disclosed in the tax return; and (b) preparing and maintaining detailed transfer pricing documentation, if required.

When filing annual tax returns, enterprises whose annual amount of related party tangible goods transactions is below RMB 200 million and whose amount of related party intangible goods transactions is below RMB 40 million should submit the "Enterprise Annual Reporting Forms for Related Party Transactions of the People's Republic of China", which in total consists of nine separate forms. These should be submitted in Chinese by May 31 of the following year (the same deadline as annual tax returns).

In addition to filing the Related Party Transaction Forms, enterprises exceeding this transaction threshold (except those that are covered by an advance pricing agreement or that have foreign shareholding below 50 percent and only transact with domestic related parties) should prepare and maintain a contemporaneous transfer pricing documentation report, prepared in line with Chinese transfer pricing regulations. Although this report need not be submitted as part of the tax return, it must be provided to the local tax bureau within 20 days upon request.

Note that the tax authorities can make transfer pricing adjustments and levy additional tax and penalties to include years when documentation may not have been strictly required. The limitation period is up to 10 years. Correlative relief under a double tax treaty cannot be claimed for any interest or penalties.

Dezan Shira & Associates provide tax consulting for foreign companies in China. For more information, please contact us at *tax@dezshira.com.*

03/03

HUMAN RESOURCES AND PAYROLL

- How do I employ workers?
- How do I obtain visas for foreign employees?
- What obligations do I have as an employer?
- Termination

HOW DO I EMPLOY WORKERS?

China allows for four different types of employment contacts:

- Fixed-term contract
- Non-fixed term contract
- Job contract
- Part-time contract

Fixed-term contract

The fixed-term contract creates an employer-employee relationship for a fixed length of time, and can be used for part-time or full-time work. A written contract must be signed within one month of the employee's first day of work; otherwise the employer risks having to pay out double salary (for each month without a contract) or having the relationship deemed a non-fixed term contract by default (after one year without a contract).

A fixed-term contract can be renewed only once, after which it will be necessary to give the employee a fixed-term contract when renewing for a second time. Employers are able to stipulate a probationary period at the beginning of the contract, during which time it is comparatively easier to dismiss the employee and he or she can be paid a temporarily reduced salary. The length of the fixed-term contract will determine the maximum length of probation the employer can set. Certain clauses may be inadmissible according to Chinese law, while others are mandatory. Companies

Non-fixed term contract

Based on its unrestricted term and limited grounds for termination, the non-fixed term contract effectively guarantees the employee job security until retirement. Specifically, an employee on a non-fix term contract can only be terminated based on grounds eligible for immediate dismissal, dismissal with 30 days' notice, or as part of a mass lay-off (and even then employees on non-fixed term contract must be prioritized over other employees).

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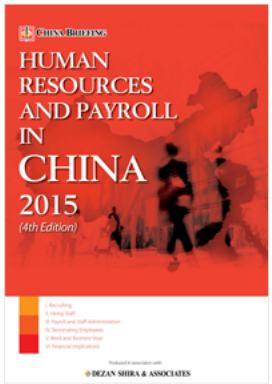

Human Resources And Payroll in China 2015 (4th Edition)
March, 2015

This updated guide provides a firm understanding of China's laws and regulations related to human resources and payroll management - essential information for foreign investors looking to establish or already running a foreign-invested entity in China, local managers, and HR professionals needing to explain complex points of China's labor policies.
See more *here*

Job contract

Due to its lack of legal clarity, the job contract is an unpopular choice in China. This type of contract is defined by the specific task or project an employee is to work on, not the length of time. Once the project is completed, the employment relationship comes to an end, and the company must pay severance to the employee. No probationary periods are permitted.

Job contracts are sometimes used for seasonal jobs where the scope of work can be defined very clearly. However, in most cases, defining the completion of a project can prove to be a challenge. The relevant legal framework offers no guidance on what to do when a project is left uncompleted, or how employees should be compensated in such a case, making job contracts more prone to disputes and even litigation.

Part-time contract

The part-time contract is only used by employers in limited circumstances, and has five characteristics:

- The employee may not work for more than four hours per day, or 24 hours per week
- No probation period is allowed, and either the employer or employee may end the agreement at any time
- The employee is not entitled to severance compensation
- The employee must be paid at least every 15 days
- Part-time employees need not receive a written contract.

Such a contract could be appropriate, for example, for an office cleaner or another role where the employee's tasks can be completed within a relatively short period of time each day.

ADAM LIVERMORE
Partner
Dalian Office

"Most people are aware of the importance of employment contracts in China, but many foreign investors ignore the value of the employee handbook/confidentiality agreement."

HOW DO I OBTAIN VISAS FOR FOREIGN EMPLOYEES?

Based on amendments to China's visa regulations in September 2013, the following types of visas are applicable to foreigners seeking to do business in China, with varying limitations on their permitted activities:

- F Visa
- M Visa
- Z Visa
- R Visa

F Visa

The F Visa, also known as the business visa, was used previously by foreign nationals coming to China on business but not employed by a Chinese entity. However, the new regulations have limited the scope of this type of visa to non-commercial purposes only, such as cultural exchanges, visits and inspections. As such, it is no longer appropriate except within its limited range of permitted activities.

M Visa

The regulations also introduced a new visa for business travelers called the M Visa. This is applicable to foreigners coming to the country for business and trade purposes of no more than six months (180 days). Like the previous F Visa, M visas are most suitable for foreigners who will:

- Spend less than six months in China during any one calendar year
- Frequently enter and leave China
- Not hold a formal senior position at an entity based in China
- Not be paid by a company incorporated in China

M Visas can be renewed after six months at the discretion of the immigration bureau and with the risk of rejection rising as the foreigner continuously resides in China for a longer period of time.

Z Visa

The Z Visa remains the most common visa type used by foreigners working in China on a permanent, full-time basis. Strictly speaking, the Z Visa only allows entry into China, after which the employee will need to subsequently apply for a residence permit. The residence permit allows the foreigner to stay in China for a specified length of time, usually one year. It also allows the foreigner an unlimited number of trips into and out of the country.

R Visa

Another new visa type is the R visa, issued to high-level foreign personnel and those possessing skills that are in shortage in China. To date, the meaning of "high-level personnel" is not entirely clear, but it likely refers to a company's senior management. Both the Z and R Visas may be considered work visas; however, the requirements for the latter, stipulated locally, are considerably higher than the former.

Major Purpose of Visit	Visa Type	Eligibility
Exchanges, visits, study tours and other activities	F	Foreigners invited to China for exchanges, visits, study tours and other activities.
Commerce & Trade	M	Foreigners invited to China for commercial and trade activities.
Employment and Commercial performances	Z	Foreigners taking up a post or employment, or giving commercial performances, in China.
Employed or hired as an introduced talent	R	Foreigners considered highly qualified talent or whose skills are urgently needed by China.

Visa quotas

While officially, there is no regulation explicitly stipulating the number of expats a single company can hire in China. In practice, however, local government agencies have a habit of refusing applications for foreign employees over a certain limit.

Based on the experience of Dezan Shira & Associates, when assessing whether it is necessary for a company to hire foreigners, and if so, how many, the authorities consider things like the applicant's business scope and size, registered capital, and internal structure, as well as the specific position in question. For example, a company with low registered capital wanting to hire a large number of foreigners is very likely to see its applications refused.

There are, however, no firm rules on the matter, and companies are instead reviewed on a case-by-case basis. To get an understanding of how many foreigners you will likely be allowed to hire, foreign investors may directly enquire with the relevant authorities, providing details such as their registered capital and target industry, or contract the services of a qualified consultancy.

WHAT OBLIGATIONS DO I HAVE AS AN EMPLOYER?

Minimum wages across China

Determining the minimum wage in China is complicated by several factors specific to the country: firstly, wage standards are set for individual cities, provinces and other administrative units by their respective local governments, rather than on a nationwide basis. Next, each of these principalities is divided into a number of wage classes, whose minimum wages vary according to local socioeconomic conditions. Lastly, minimum wage is differentiated between minimum monthly salary and minimum hourly wage (for full-time and part-time workers, respectively). According to China's "Employment Promotion Plan", the minimum wage in each jurisdiction must be increased at least once every two years; meanwhile, the "Five-Year Plan for 2011-15" stipulates an average increase of 13 percent per year.

Overtime

In China, overtime is paid differently depending on the work hour system adopted by the employer: standard work hours, comprehensive work hours or non-fixed work hours. Note that the latter two of these require special approval to implement.

The standard work hour system requires that an employee's normal working day should not exceed eight hours, that the normal working week not exceed 40 hours, and that each employee should be guaranteed at least one rest day per week. The majority of white-collar jobs in China now operate according to this model.

Rather than a unit of one week, the comprehensive work hour system adopts a set period (typically one month) as the base to calculate the employee's working hours. Although the distribution of hours worked during this period can be irregular, the average number of working hours per day and per week should roughly correspond to the levels set out in the standard work hour system.

Lastly, the non-fixed work hour system is geared towards positions like senior management, salespeople, and employees in the transport, warehousing and railway sectors - who generally do not receive overtime payments, as it is considered impractical to measure their time spent working.

Social insurance

Social insurance payments in China (also called "social welfare" or "mandatory benefits") are mandatory contributions to government-run funds made by both the employer and the employee (whose contribution the employer is responsible for withholding each month).

Social insurance obligations from the employee and employer, respectively, can vary considerably depending on the city in which the contributions are being made. For a company with employees based in a number of cities around the country, this means that the overall cost to the company for an employee earning a monthly salary of RMB 10,000 in one city may be quite different to someone on the same salary based elsewhere.

In total, there are five social security funds:

- Pension
- Unemployment
- Medical
- Occupational injury
- Maternity

Added to these is a mandatory housing fund not strictly considered a type of social welfare, but generally included within the scope of social security. Housing fund contributions are mandatory and come from both the employer and the employee, apart from some special areas where the employee does not need to make a contribution. Money in the housing fund can be used by employees to pay the initial down-payment on a house, or to subsequently pay back a loan to the bank.

While employees are also mandated to make their own contributions to several types of social insurance, the portion contributed by the employer is normally the higher of the two sides. In fact, social security payments typically add an additional cost of between 30 and 45 percent of an employee's salary each month.

Mandatory contribution rates are stipulated by local governments and the exact calculations involved can be quite complicated. Percentages are not technically based on the employee's monthly salary, but rather on a theoretical "base" salary stipulated differently from city to city.
In late 2011, the Chinese government announced that foreigners are to be included in the social insurance system at the same rates as Chinese citizens (excluding the housing fund); however, to date implementation has varied by region, with some cities such as Shanghai having yet to mandate social insurance payments for foreigners at all.

Given the complicated requirements for social insurance contributions, many companies choose to outsource their payroll processing and related human resources administration services. This has the added benefits of ensuring continuity (which can falter if an HR manager is absent or suddenly resigns), transparency and the confidentiality of salary information.

HELEN KONG
Manager
HR Administration &
Payroll Services
Dalian Office

"Outsourcing payroll processing allows for greater transparency, efficiency, accuracy, confidentiality, and continuity, as well as cost savings and ensured compliance with all laws and regulations."

MANDATORY BENEFIT TYPES

Medical
In the event of illness/injury, an employee can have part of the treatment cost covered by medical insurance. Contributions accrue to a card that can be used for pharmacy or out-patient costs in government-approved hospitals and clinics (excludes international clinics).

Unemployment
In the event of redundancy (not in the event an employee chooses to resign), on the precondition that an employee has contributed to unemployment for at least one continuous year, the employee may claim unemployment benefits for a maximum of 24 months.

Housing Fund
Designed to ensure that workers save to purchase housing. Money from this fund can be used to pay the initial down-payment on a house. In most cases, a company determines the contribution rate (within the legal range) when opening its social insurance account.

Work-related Injury
The work-related injury fund covers the cost of treatment should an occupational injury occur. The employer must pay some salary during the period of rehabilitation and, if the employee cannot return to work, compensation must be paid.

Pension
On the precondition that contributions have been made for at least 15 years, upon reaching retirement, an individual can receive a pension based on the amount accumulated in his/her individual fund.

Maternity
Maternity leave is usually three months and paternity leave is generally less than 15 days. In cities in which maternity insurance is applicable, during a period of maternity or paternity leave, salary is not required to be paid; rather, the employee receives a fixed sum from this insurance fund.

■ = "Five Social Insurances"

SOCIAL SECURITY FUND CONTRIBUTIONS		
Fund	Approximate Contribution (% of emplyee's monthly salary)	
	Employee	Employer
Pension	8%[1]	10-22%[2]
Unemployment	0.1-1%	0.2-2%
Medical	2%[2]	7-12%[2]
Occupational injury	N/A	0.4-3%[3]
Maternity	N/A	0-1%
Housing Fund	Normally matched with employer	7-13%
Total	10.1%+	24.6-53.0%

Source: Dezan Shira & Associates
1 Uniform nationwide
2 Much lower in some cities
3 Also depend on the degree of danger during work

TERMINATION

LINA WANG
Manager
Business Advisory Services
Dalian Office

"Updating HR data with government agencies can be a time-consuming and tedious process. Outsourcing these tasks can reward a company with significant time savings."

From a legal perspective, terminating employees in China can be more difficult than expected, especially under the comparatively stringent regulations on terminating employment contracts since 2008. Employers should follow the below steps to ensure compliance with all relevant statues:

Step 1 - Determine whether the termination is an early termination or not. If the employer chooses to terminate the employer prior to the expiration of the first fixed-term contract, this is considered "early termination" and certain additional requirements apply.
Step 2 - In case of early termination, the employer should attempt to negotiate an agreement with the employee, including the termination date, severance payment and any other necessary details. This is often the safer option even if there are grounds for unilateral termination.
Step 3 - If unable to come to a termination agreement, consider whether there is grounds to support immediate termination for cause or 30-day notice termination without cause, keeping in mind the statutory obstacles to such forms of termination

If none of the above measures can be adopted, then the termination is likely to be considered an unlawful termination and severance payment might be required.

For assistance with automating you HR processes or advice on drafting labor contracts, Please contact us at *hr.admin@dezshira.com.*

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