



PrimeGlobal

*An Association of
Independent Accounting Firms*

DOING BUSINESS IN CHINA



CLAYTON  **McKERVEY**



COMPANY FORMATION IN CHINA

MAIN FORMS OF COMPANY/BUSINESS IN CHINA

When contemplating setting up a business in China, depending on the needs and goals for your Chinese investment, you will need to determine the structure of the entity to be set up as there are several choices available.

1) REPRESENTATIVE OFFICE (RO)

- A RO is not considered a separate legal entity in China and is, rather, a Chinese representation of a foreign company.
- Setup of a RO would allow you to conduct research and market surveys related to the products or services of the head office, engage in the head office's product or service displays or promotional activities, liaise in connection with product sales, the provision of services, domestic investment by the RO's head. However, a RO cannot issue invoices (FAPIAO), cannot engage in profit making activities, and cannot receive payments.
- *Incorporation time: About 1-2 months*

2) WHOLLY FOREIGN-OWNED ENTERPRISE (WFOE)

- A WFOE is considered a separate legal limited liability entity in China which offers full independence with no need to engage a Chinese partner.
- It is allowed to hire Chinese nationals directly and is authorized to issue a visa to expatriates. The staff must be provided with contracts duly prescribed under Chinese law concerning matters of employment, remuneration, dismissal, welfare benefits, etc.
- Registered foreign capital will be the main source of funding.
- *Incorporation time: About 3-5 months*

Depending on business type, activity, and location. The duration for the setup of a WFOE in a free trade zone in China is even less (about 2-3 months) with reduced administrative requirements. In addition, free trade zone benefits the WFOE with better clarity on what industries are encouraged and what industries are forbidden and relaxed customs rules for trading goods and liberal flow of currency.

3) EQUITY JOINT VENTURE (EJV)

- An EJV is a limited liability company in which the profits and losses are distributed between parties according to the capital in proportion to their respective equity. It requires a Board of Directors and contractually appointed management team.
- *Incorporation time: About 3-5 months*

4) CONTRACTUAL JOINT VENTURE (CJV)

- A CJV can operate as a limited liability company or as a non-legal person.
- Profits and losses are distributed according to provisions of CJV contracts.
- *Incorporation time: About 3-5 months*

SPECIFIC TAX CONCERNS RELATED TO ESTABLISHING A COMPANY

For foreigners doing business in China, tax is always a key concern. Income derived from China may be subject to taxes in both your home country and China which could substantially increase your overall tax burden. China has a double taxation with more than 150 countries which may offer you a tax shield. Understand the taxation rules of China and make sure you are not double taxed. You as an individual or as a company may also be entitled to deductions, exemptions, tax credits, or subsidies.



LEGAL ISSUES RELATED TO ESTABLISHING A COMPANY

- 1) Business scope:** Business scope in China is much more detailed than in other countries and the details will appear on the business license. The business scope can be modified later, but this will require further approvals and is therefore slow to become effective.
- 2) Special License:** A specific license may be required to set up a company in certain industries.
- 3) Switching Investment Vehicle Type:** Changing from a rep office setup to a WFOE setup is not as easy, as it involves both closing of the RO and setting up of a WFOE, which requires similar efforts as it does to open a new WFOE and is more costly. However, both the closing and the opening can be done in parallel.
- 4) Labour Issue:** A representative office is by law restricted from hiring employees directly and can only hire the local staff through a local employment agency.
- 5) Social Welfare Contribution** is mandatory for all foreigners working in China except in a few cities, including Shanghai, where it is voluntary for the time being.

CULTURAL CONCERNS RELATED TO ESTABLISHING A COMPANY

Chinese culture is deeply reflected in the business world. Business is built upon connections known as GUANXI. Face culture is an integral part of doing business in China, where face is everything for Chinese people to maintain their guanxiwang.

In many cases, hiring local staff can assist the foreign company in overcoming cultural differences. However, over-reliance on local staff with business relationships may not be prudent.

Unlike in the West, in China, a business leader is looked upon as a sole decision maker. It is due to these differences that foreign businesses in China become the victim of "business fraud", as fraud is not easy to detect and is often very costly.

OTHER COUNTRY-SPECIFIC ISSUES RELATED TO ESTABLISHING A COMPANY

- 1) Fraud:** Never underestimate control needs for your business in China. There are too many books collecting stories of naive foreigners losing their companies in China to fraud practices. Be generous in dedicating your resources to control. Make yourself aware of fraud prevention mechanisms and local regulations in China.
- 2) Financing:** Relying too much on refinancing within China may be a mistake. It is a hazardous process if cash flows are not estimated well ahead of time. Foreign exchange control in China limits the amount of that can be borrowed from a parent company overseas. Local and foreign banks are quite reluctant to lend to a new company without a high level of securities.
- 3) Hiring issues:** There is a common misperception about China that China, with a population of 1.3 billion, provides access to a limitless pool of workers. However, when companies start looking for a specific professional profile, it may not be as easy as you originally thought.
- 4) Talent retention issues:** Staff turnover rates are extremely high in China, and retaining quality managers over the long term is challenging. It is important to have the right HR team in place that understands the motivating factors for the local employees.
- 5) IP issues:** Do not just assume that IP rights are automatically protected under Chinese law.
- 6) Accounting issues:** You will probably be surprised by the local accounting culture, which is more oriented to tax and cash reporting than to reporting as required by accounting standards.



PERMANENT ESTABLISHMENT IN CHINA: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

The term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term "permanent establishment" includes especially a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

If the home country of a foreign company has a double tax agreement (DTA) with China, it may be able to get a corporate income tax exemption if the establishment does not constitute a permanent establishment (PE) under the relevant DTA. DTA aims to prevent income from being taxed by two or more countries through tax credits.

According to the various DTAs, foreign companies can be deemed to have a PE in China in the following situations:

- 1) Fixed place PE:** has an establishment or place of business in China;
- 2) Construction PE:** has a building site, a construction, assembly, or installation project or related supervisory activities that last for a certain period of time;
- 3) Agent PE:** appoints an agent in China to conclude contracts or accept orders in China; or
- 4) Service PE:** has employees working in China for a certain period of time.

China has signed DTA(s) with over 100 different countries, including Hong Kong and Macau. DTA(s) signed in the past adopted a 6 month rule to determine PE status, but in the recently signed DTAs, the 6 month rule has changed to a 183 days rule. The DTA signed between China and France adopts the 6 month rule, and according to that rule, the term "permanent establishment" likewise encompasses:

- a building site, or construction, assembly, or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than 12 months;
- the furnishing of services, including consultancy services, by an enterprise through employees or other personnel who are present in a contracting state for such purpose, but only if activities of that nature continue (for the same or a connected project) within that contracting state for a period or periods aggregating more than 183 days within any 12 month period.

The start and end dates of the aforesaid activities may be determined in accordance with the date on which the contract starts to implement after execution of the contract to the date on which all works have been completed and delivered.

Furthermore, if the foreign enterprise undertakes two or more consecutive projects in the same construction, the projects will count together towards the six month period.

Presence of employees in China: Where a person is acting in China on behalf of the non-resident enterprise and that enterprise shall be deemed to have a permanent establishment in China in respect of any activities which that person undertakes for the enterprise if the employee stays in China for more than six months within a 12 month period. The labor services shall refer to professional services and activities such as engineering, technology, management, design, training, consultancy, etc.

The duration of stay shall be calculated based on the period of stay of all the employees providing labor services in China in different time periods. However, the duration of stay for the same batch of employees working in the same period shall not be calculated separately.

Among other things, dispatch of personnel to provide services in China may trigger permanent establishment issues if



the dispatching enterprise assumes partial or full responsibility and risks for the work of the dispatched personnel, and examines and assesses their work performance regularly the enterprises should be regarded as having established an agency and premises to provide labor services; if the dispatching enterprises are enterprises of tax treaty contracting parties and the institution or premises are relatively fixed and permanent, the institution or premise shall be regarded as a permanent institution in China.

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

- 1) Legal type:** Branch is not a separate legal entity but an extension of the subsidiary. Subsidiary is a separate legal entity distinct from its parent company.
- 2) Liabilities:** Branch office liabilities are extended to the subsidiary; the subsidiary's liabilities are limited to itself.
- 3) Entity name:** Branch office must have the same as the subsidiary with city and branch location. Subsidiary can have the same name or different one from the parent company.
- 4) Annual filing:** Branch office must file the branch office as well as the subsidiary's accounts; a subsidiary must file its own accounts. The books must be closed by year end and annual tax must be filed by April.
- 5) Set up another branch:** Branch office cannot open another branch office in Mainland China; subsidiary can open its branch office in Mainland China.

TAX AND ACCOUNTING OBLIGATIONS

Subsidiaries and branches must perform corporate tax filing every quarter and file annual returns by the end of the accounting year - i.e., December 31st.

REGISTRATION FORMALITIES

Registration formalities for both the subsidiary and the branch are the same:

- 1) Apply for company name approval (exception: branch will keep the same company name as its parent company)
- 2) Obtain certificate of approval
- 3) Obtain business license registration
- 4) Apply for organization code certificate
- 5) Obtain tax registration
- 6) Register with several bureaus
 - Customs Bureau
 - Statistics Bureau
 - Finance Bureau
 - Safe
 - Open a Bank Account

STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

Chinese subsidiary companies need to submit their own books of accounts, profit or loss statement, and balance sheet when filing annual returns in Mainland China. However, branch offices may be required to submit the audited accounts of the the parent company as well, since it is simply an extension of the foreign head office.

The company will need to fill in an extensive list of administrative files containing general and financial information to be remitted to 7 different administration departments for the purpose of annual evaluation. The files shall be done both online and on specific paper forms as provided by the corresponding local authorities.



HOW TO HIRE MY FIRST EMPLOYEE IN CHINA

MAIN LEGAL STEPS TO FOLLOW TO HIRE A FIRST EMPLOYEE

Just as China's economy is developing rapidly, so is its labor protection system. Steps to follow when hiring your first Chinese employee:

- 1) Sign labor contract directly or via a recognized HR agent in China, if direct hiring is prohibited by law.
- 2) Do filing with the labor bureau and pay social insurance and housing fund. It can be done either by the company or an agent on behalf of the company.
- 3) Prepare pay slip every month.
- 4) Compute individual income tax and file with local tax bureau.

DESIGN AND CONTENTS OF AN EMPLOYMENT CONTRACT

See Sample Enclosed.

CAN SOMEBODY DO BUSINESS FOR ME AND NOT BE AN EMPLOYEE?

Foreign companies can engage a local individual for carrying out its activities in China. The local individual will stay on the payroll of the local employment agency and will be remunerated for his services by the local agency. The local agency can charge back the service fee to the foreign entity.



HOW TO READ FINANCIAL STATEMENTS IN CHINA

SAMPLE BALANCE SHEET

XYZ COMPANY LIMITED (SHANGHAI)

31/Jul/15

资 产	ASSETS	ACTIF	Row	As at Dec 2014
流动资产:	Current assets	ACTIF CIRCULANT	1	-
货币资金	Cash	Disponibilités (dont caisse)	2	-
短期投资	Short term investment	Valeur de placement	3	-
应收票据	Notes receivable	Effets à recevoir	4	-
应收股利	Dividend receivable	Dividendes à recevoir	5	-
应收利息	Interest receivable	Intérêts à recevoir	6	-
应收帐款	Accounts receivable	Créances clients	7	-
其他应收款	Other receivable	Autres créances	8	-
预付帐款	Deposits to suppliers	Acomptes fournisseurs	9	-
应收补贴款	Allowance receivable	Indemnités à recevoir	10	-
存货	Inventories	Stocks et en-cours	11	-
待摊费用	Deferred and prepaid expenses	Charges constatées et payées d'avance	12	-
一年内到期的长期债权投资	LT investment due within a year	Invest. à LT dûs pdt l'exercice en crs	13	-
其他流动资产	Other current assets	Autres actifs circulants	14	-
流动资产合计	Total current assets	Total actif circulant	17	-
长期投资:	LONG TERM INVESTMENTS	INVESTISSEMENTS A LONG TERME	18	-
长期股权投资	Long term dividend investments	Dividendes sur investissement à LT	19	-
长期债权投资	Long term bonds investments	Obligations à long terme	20	-
长期投资合计	Total long term investments	Total Investissement a long-terme	24	-
	FIXED ASSETS	IMMOBILISATIONS	25	-
固定资产原值	Fixed assets - cost	Immobilisations corpo. (VO)	26	-
减: 累计折旧	Less:accumulated depreciation	Moins : Amortissements cumulés	27	-
固定资产净值	Fixed assets - net book value	Immobilisations corpo- VNC	28	-
减: 固定资产减值准备	Less:Prov.for devalued fixed assets	Moins : Prov./ immobilis. dévaluées	29	-
固定资产净额	Net value of fixed assets	Valeur nette des immobilisations	30	-
工程物资	Construction materials	Matériaux de construction	31	-
在建工程	Construction in progress	Construction en cours	32	-



固定资产清理	Disposal of fixed assets	Cession d'immobilisations	33	-
固定资产合计	Total fixed assets	Total immobilisations	36	-
无形资产及其他资产:	Intangible assets and other assets	Actifs incorporels et autres actifs	37	-
无形资产	Intangible assets	Actifs incorporels	38	-
长期待摊费用	LT deferred & prepaid expenses	Charges a LT constatées d'avance	39	-
其他长期资产	Other intangible assets	Autres actifs incorporels	40	-
无形资产及其他资产合计:	Total intang. assets & other assets	Total actifs incorporels et autres	44	-
递延税项:	Deferred tax:	Impôts différés	45	-
递延税款借项	Deferred tax debit	Impôts différés au debit	46	-
资产总计	TOTAL ASSETS	TOTAL ACTIF	48	0.00

负债和股东权益	LIABILITIES AND CAPITAL	PASSIF	Row	As at Dec 2014
流动负债:	CURRENT LIABILITES	Dettes à court-terme	50	-
短期借款	Short term loans	Prêts à court-terme	51	-
应付票据	Notes payable	Effets à payer	52	-
应付帐款	Accounts payable	Dettes fournisseurs	53	-
预收帐款	Advance from customers	Acompte clients	54	-
应付工资	Accrued payroll	Charges de personnel constatées d'avance	55	-
应付福利费	Welfare & benefit payable	Charges soc.& avantages sociaux à payer	56	-
应付股利	Dividend payable	Dividendes à payer	57	-
应交税金	Tax payable	Impôts et taxes à payer	58	-
其他应付款	Other payments	Autres paiements	59	-
其他应付款	Other payable	Autres dettes courantes	60	-
预提费用	Accrued expenses	Charges constatées d'avance	61	-
预计负债	Contingent liabilities	Dettes potentielles	62	-
一年内到期的长期负债	Long term loans <1 year	Prêt à LT du pendant l'exercice en cours	64	-
其他流动负债	Other current liabilities	Autres dettes à court-terme	65	-
流动负债合计	Total current liabilities	Total Dettes à court-terme (I)	66	-
长期负债:	LONG TERM LIABILITIES	DETTES A LONG-TERME	67	-
长期借款	Long term loans	Emprunts a long terme	68	-
应付债券	Bonds payable	Obligations à payer	69	-
长期应付款	Premium on bonds payable	Prime sur les obligations à payer	70	-



专项应付款	Special payable	Dettes exceptionnelles	71	-
其他长期负债	Accounts payable due > 1year	Dettes fournisseurs > 1 an	72	-
长期负债合计	Total long term liabilities	Total dettes à long-terme (II)	73	-
递延税项	Defered tax:	Impôts différés	75	-
递延税款贷项	Defered tax credit	Impôts différés au credit (III)	76	-
负债合计	Total liabilities	Total Dettes (I+ II + III)	77	-
股东权益:	SHARE CAPITAL EQUITY	Capitaux propres	78	-
股本	Paid-in Capital - Money from HQ	Capital social versé	80	-
资本公积	Capital surplus	Primes d'émission, de fusion, d'apport	81	-
盈余公积	Surplus reserve	Réserves	82	-
其中: 公益金	Including: welfare reserve	Dont : fonds social	83	-
本年利润	Current year profit	Résultat de l'exercice	84	-
年初未分配利润	Opening undistributed profit	Report a nouveau	88	-
股东权益合计	Total share capital equity	Total capitaux propres	96	-
负债和股东权益总计	CAPITAL EQUITY& LIABILITIES	TOTAL PASSIF	97	0.00



SAMPLE INCOME STATEMENT

XYZ COMPANY LIMITED (SHANGHAI)

Currency: RMB

PRC	Chinese Description	French/English Description	Current Period			Acc.	% in of sales
			Jan/15	Feb/15	Mar/15	Jan-Dec.2015	
5101	主营业务收入	Ventes - Sales Revenue	-	-	-	-	1.00
5401	主营业务成本	Couts de revient des ventes- Cost of sales and Services Rendered	-	-	-	-	
5402	主营业务税金及附加	Business tax-Sales Tax	-	-	-	-	
	主营业务利润	Marge brute sur ventes- Gross Profit on Sales	-	-	-	-	
5501	营业费用	Charges d'exploitation- Operating Expenses	-	-	-	-	
5502	管理费用	Frais generaux- G&A expenses	-	-	-	-	
5405	其他业务支出	Autres charges de gestion- Other expenses	-	-	-	-	
5503	财务费用	Charges financieres- Financial Expenses	-	-	-	-	
5102	其他业务收入	Autres revenus- Income from other operation	-	-	-	-	
	营业利润	Resultat d'exploitation -Operation profit	-	-	-	-	
5201	投资收益	Produits et revenus de valeurs mobilières- Investment Income	-	-	-	-	
5301	营业外收入	Produits hors exploitation- Non-operating Income	-	-	-	-	
5601	营业外支出	Charges hors exploitation- Non-operating Expenses	-	-	-	-	
	利润总额	Resultat avant impots-Total Profit before tax	-	-	-	-	
		Accumulated profit before tax	-	-	-	-	
5701	企业所得税	Income tax	-	-	-	-	
	净利润	NET PROFIT	-	-	-	-	
		Net profit for the year	-	-	-	-	
		Retained earnings at beginning of year	-	-	-	-	
		Adjustment of Prior Year's Income/Loss	-	-	-	-	
		Retained earnings at end of year	-	-	-	-	
	息税前利润	EBITDA	-	-	-	-	