

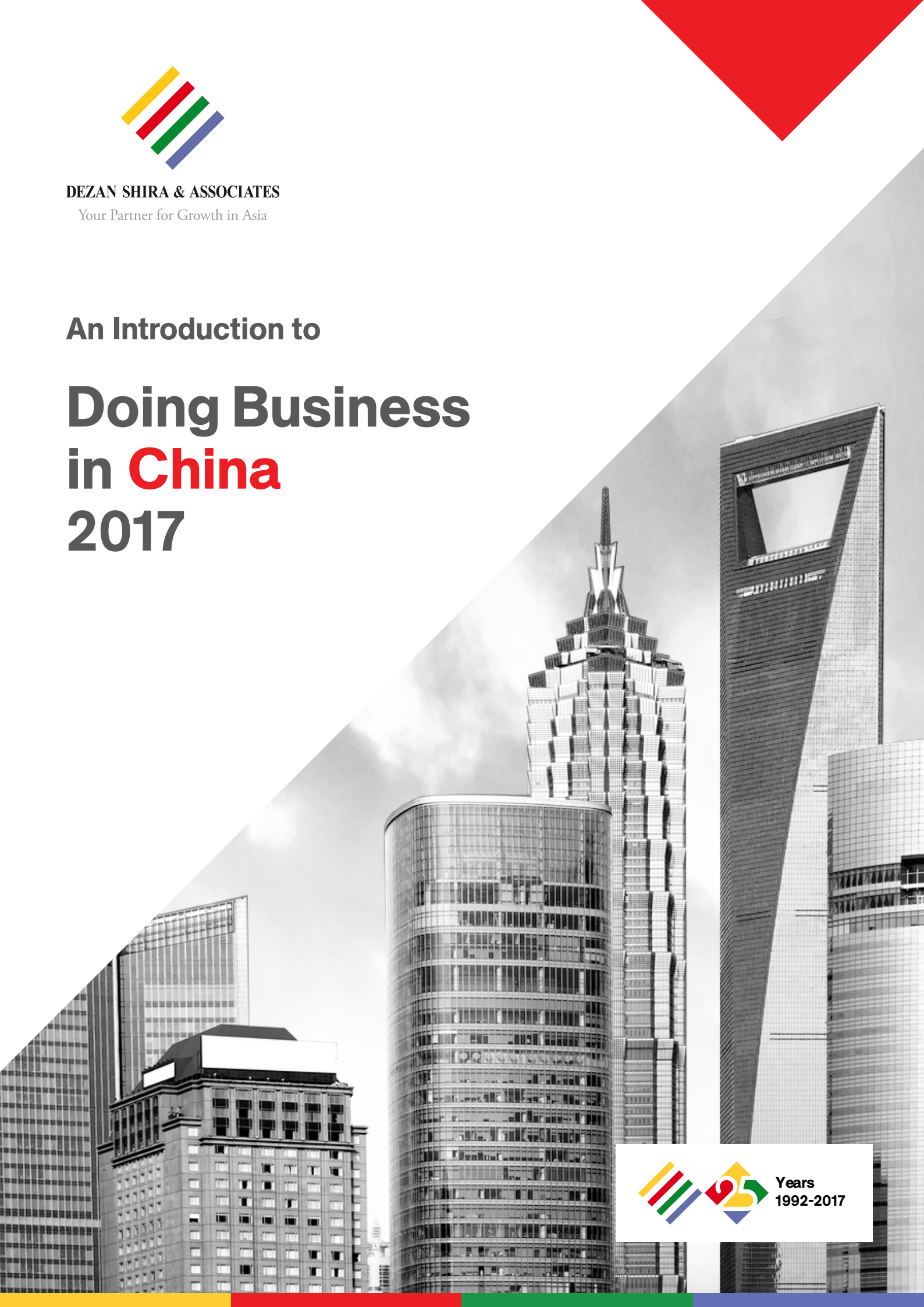


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An Introduction to

Doing Business in China 2017



**Years
1992-2017**



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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 as Managing Editor and Zhou Qian as technical editor. Creative design of the guide was provided by Jessica Huang, Kking Lu and Belén Rodríguez

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DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia



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 25 years of on-the-ground experience and a large team of professional advisers, we are your reliable partner in Asia

Preface

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. However, the relentless momentum of investors turning their sights towards China has softened of late. A slowed projected GDP growth of 6.7 percent in 2016 – the lowest in 25 years – combined with stock market volatility has caused alarm among observers.

While some of these fears are grounded in reality, others are overblown. After decades of rapid growth and development, the Chinese economy is inevitably changing. The Middle Kingdom is undergoing a major overhaul, transitioning to have a service and consumption driven economy rather than one based purely on manufacturing and export. This transition is not unconditionally negative for the country's competitiveness, and is understandably changing the way in which investors approach and operate in the country. In fact, between January and November 2016, foreign investment in China exceeded US\$110 billion, a growth of nearly 34 percent year-on-year.

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 84th out of 189 economies surveyed in the World Bank's 2016 '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, Ch: 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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Establishing and Running a Business

- ◆ **What are my options for investment?**
- ◆ **How do I establish a business?**
- ◆ **How do I make changes to my business?**

What are my options for investment?



RICHARD CANT

Director

North America

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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, and investment size.

In this section, we discuss:

1. Representative office (RO)
2. Joint venture (JV)
3. Wholly foreign-owned enterprise (WFOE)
4. Other options

The 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 the business scope, as this is connected to the "Catalogue for the Guidance of Foreign Invested Enterprises" (most recently updated March 10, 2015, hereinafter, "the Catalogue"), a policy document 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. Fapiaos 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, or else risk having to 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 the company is in a position to fund itself. According to the revised Company

“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.”

Law (effective March 1, 2014), the minimum registered capital requirements for corporate establishment have been removed generally except for a few industries, and the previous system of paid-up capital has been replaced by a subscribed capital model (under which a schedule of contributions must be registered with SAIC). Additionally, the revised Company Law removed the requirement that 30 percent of one's registered capital consist of a cash contribution.

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 be 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, 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 freely wired out again.

- **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.

In addition to the options discussed in the following pages, some investors choose to invest in China via a merger and acquisition (M&A). Acquisitions of equity and assets require 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 sale of the company's products 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 representatives can be hired per RO.

ROs are taxed as a permanent establishment in China, 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 the 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 in a restricted industry sector, where the law permits foreign investment only via a joint venture with a Chinese partner; and,

- The foreign investor wants to make use of the sales channels and network of a Chinese partner who has local market knowledge and established contacts.

There are two types of JVs in China, and they differ primarily in terms of how profits and losses are distributed.

1. 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.
- The Chinese legal person has limited liability.

2. 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 enterprise (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 Catalogue divides industries into three categories: those encouraged, restricted, and prohibited for foreign investment. Industries not listed in the Catalogue are generally permitted. Please note that different rules may apply in certain special areas; for example, in China's Free Trade Zones, foreign investment is permitted in any industry not expressly prohibited within the "negative list" of that zone, 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. 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 because it combines 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 (a general partnership or a 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 through 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.



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Foreign-invested joint stock company

Foreign-invested joint stock companies are similar to typical Western corporations. This structure offers the advantage of shared ownership between Chinese and foreign companies, 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 an extremely large investment of initial capital.

Comparison of Different Investment Options

Investment options	Common purpose(s)	Pros	Cons
Representative office (RO)	<ul style="list-style-type: none"> Market research Liaise with overseas headquarters 	<ul style="list-style-type: none"> Easiest foreign investment structure to set up No registered capital requirement Paves way for future investment 	<ul style="list-style-type: none"> Cannot invoice locally in RMB Must recruit staff from local agency; no more than four representatives
Wholly foreign-owned enterprise (WFOE)	<ul style="list-style-type: none"> Manufacturing Servicing Trading (if a FICE) 	<ul style="list-style-type: none"> Greater freedom in business activities than RO 100% ownership and management control 	<ul style="list-style-type: none"> Registered capital requirement (for select industries) Lengthy establishment process
Joint venture (JV)	<ul style="list-style-type: none"> Entering industries that by law require a local partner Leveraging a partner's existing facilities, workforce, sales/ distribution channels 	<ul style="list-style-type: none"> See common purpose(s) 	<ul style="list-style-type: none"> Split profits Less management control than a WFOE Technology transfer/IP risks Inheriting partner liabilities
Foreign-invested partnerships (FIP)	<ul style="list-style-type: none"> Investment vehicle Servicing 	<ul style="list-style-type: none"> Allows for domestic and foreign ownership Easier setup (does not require registered capital verification) Substantial tax savings 	<ul style="list-style-type: none"> Unlimited liability of the general partner Newness of structure (potential challenges with taxation or foreign currency exchange)

How do I establish a business?



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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 the 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 premises requirements
- Opening a bank account
- Intellectual property

Corporate establishment

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

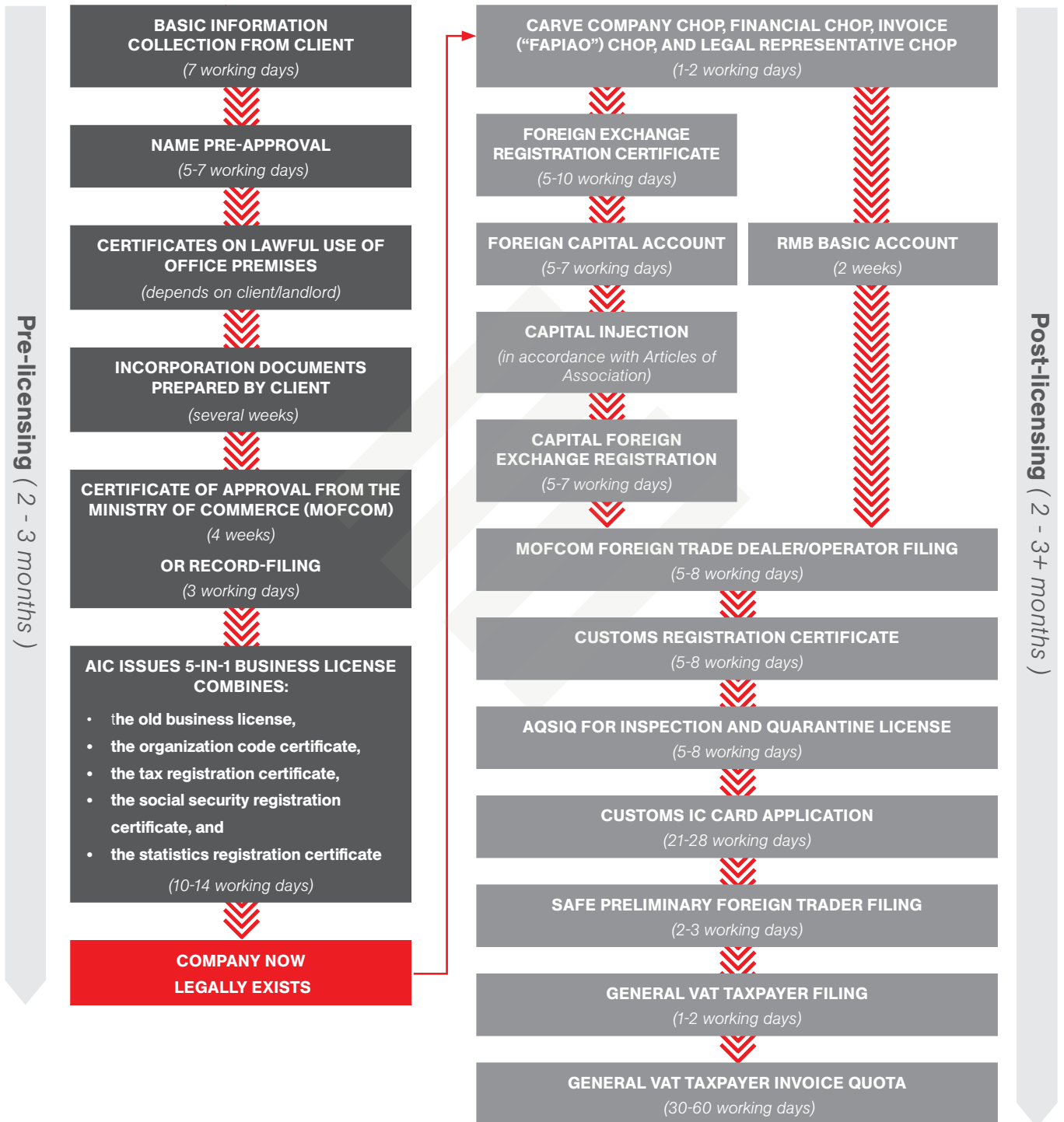
- Ministry of Commerce
- Administration of Industry and Commerce
- State Administration of Foreign Exchange
- State Administration of Taxation
- Customs Office
- Quality and Technical Supervision Bureau
- Statistics Bureau

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 their 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 are more time-consuming.

“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.”

WFOE Setup Procedure





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“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.”

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 (January 2017), the 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 cash flow to their mainland China subsidiaries. Although also a signatory to FATCA, Singapore appears to be less affected by these developments.

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 three more 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 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.

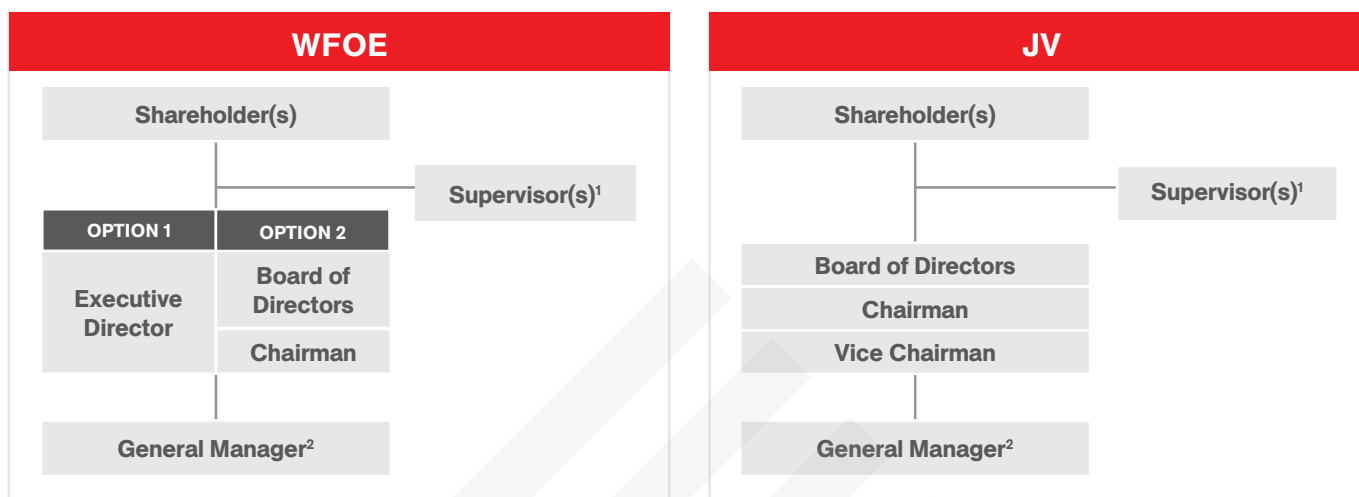
General manager

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 their 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 JV



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 premises requirements

To register a foreign-invested entity (FIE) in China, it is a prerequisite to own or lease an office premises (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 premises as required by the Chinese authorities. Usually, only one business may be registered per office unit. Under limited conditions, one office unit can be used to register multiple businesses. 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 premises is owned by the same individual or entity applying for business registration, the applicant needs to show a Certificate of Premises 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 premises; the AIC does not accept "residential" CPOs to be used as the basis of a business registration.



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Associate
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If the office premises 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 premises 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.

The land use rights certificate and/or lease agreement for the premises of the shop are also usually required to be presented to the authorities.

Representative office

Registration of ROs requires the relevant lease agreement and a copy of the CPO. ROs require special attention when choosing a suitable premises 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 premises 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 only be registered at a commercial office premises with approval from the Public Security Bureau (PSB). While this requirement is no longer mandatory, the registered office of an RO still needs to be designated for non-residential purposes, or else risk being denied for registration by the AIC.

“If an FICE intends to include retail activities in its business scope, the company needs to be registered at an address suitable for the specific retail activities. The investor is advised to double-check the suitability of the premises before signing the lease agreement.”

Opening a bank account

Account types

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

1. 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.

2. 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.

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.



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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. As of November 1, 2015, this service can be conducted without charge, but this is subject to change.


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 that 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

“China uses a “first-to-file” principle where the applicant may not receive legal protection if prior rights have been filed or are registered by another party.”



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-file” 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 (SAIC) in Beijing and its 13 newly established local offices, and costs a minimum of RMB 600 as of October 15, 2015. 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://sbsq.saic.gov.cn:9080/tmoas/agentInfo_getAgentDljg.xhtml. 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?

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

Company name

The procedure for changing the name of a company in China is quite complex. Because a company’s name is displayed on several types of official documents (such as its business license and company chop), 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 and get a new five-in-one business license. The company must also file with the MOFCOM through an online system. Both the application and the filing 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.



Business scope

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 AIC within 30 days. Subsequently, the company's 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 AIC 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 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 if it engages in specially administrated industries, i.e. restricted or prohibited categories in the Catalogue, as well as those in the encouraged category but with special requirements on equity rights or level of management. If the company focuses on industries not listed in the specially administrated industries, then it may be exempted from the onerous approval application process. Instead, a simplified record-filing process will apply, which could be conducted either before the AIC registration or within 30 working days of the change being made.
- **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.

- **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 million or above	zero

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, SAFE, and the local Ministry of Commerce. As with other changes to company registered information, its five-in-one business license will need to be updated as well.



STEPHEN O'REGAN

Senior Associate
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Guangzhou Office

“RO-WFOE conversion”







Multinational companies operating in China through an RO occasionally encounter the need to convert their existing operations to a WFOE, as ROs are unable to engage in profit-making commercial activities. 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 either in sequence or simultaneously. 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 RO should then deregister its foreign exchange registration in the local SAFE and custom registration in the local Customs. In case it doesn't have such registrations, it still need to get correspondingly official statements from the bureaus in charge as proof.
- **Step 3** - 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 reasons for doing so and seek approval from the bank.
- **Step 4** - The enterprise can then proceed to deregister with its local 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 (工作证). 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 5** - The enterprise should conduct deregistration in the Quality and Technical Supervision Bureau and Statistics Bureau in case the RO has not received its five-in-one business license.
- **Step 6** - Notification of the RO's deregistration should then be filed with the Public Security Bureau to cancel its chops.

“ Investors need to consider the time and cost involved in the conversion process, and weigh this against the lower tax treatment and other benefits. The higher the RO's expenses are, the more convincing the case is for conversion. ”

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 while the RO deregistration process is underway.

RO Deregistration Procedure and Timeline

	Step & Instruction	Time
Phase 1	 Deregistration with National Tax bureau	20 days
	Deregistration with Local Tax bureau	20 days
Phase 2	 Deregistration with customs	10 days
	Deregistration with SAFE	7 days
Phase 3	 Closure of bank account	1 day
Phase 4	 Deregistration with AIC	5 days
Phase 5	 Cancellation of Organization Code Certificate If a five in one business license is used, then this step shall be omitted.	1 day
Phase 6	 Cancellation of chops with Public Security Bureau	20 days
		Minimum total time 84 days

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. Under the five-in-one business license policy, companies transferring to a new tax district need to close their tax account in the original tax bureau and then apply for a new five-in-one business license in the new 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.



KYLE FREEMAN

Manager
International Business Advisory
Beijing Office

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

Branch Office (BO)

Common Purpose(s)	Pros	Cons
<ul style="list-style-type: none"> Geographic expansion Alternative to relocation 	<ul style="list-style-type: none"> Simple establishment No registered capital requirement Easy maintenance (only branches wishing to invoice must declare taxable items from locally produced invoices) 	<ul style="list-style-type: none"> 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)



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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. 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)

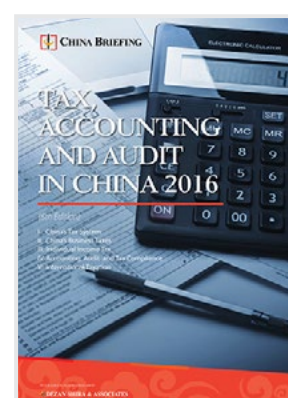
In accordance with the Individual Income Tax Law of the PRC, IIT is imposed on all individuals, including Chinese and foreign nationals, residing in or deriving income from China. PRC residents are generally subject to tax on their worldwide income, while non-residents are taxed on their PRC-sourced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

Monthly taxable income (RMB)	Tax rate	Quick deduction
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



RELATED READINGS



Tax, Accounting and Audit in China 2016 (8th Edition)
February 2016

This edition of Tax, Accounting, and Audit in China, updated for 2016, offers 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.

[AVAILABLE 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 they have spent in China, the source of their income, and where they are based.

Taxable Income of Foreign Individuals

Taxpayer status	Taxable income
Living in China \leq 90 days (183 days if there is a tax treaty in place)	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> Income sourced within China Income sourced outside of China paid by a Chinese enterprise or individual
Living in China \geq five years	<ul style="list-style-type: none"> 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 in 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.



SABRINA ZHANG

Partner
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- **Five-year test**

An individual who has stayed in China for five consecutive years must begin to pay IIT 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 for tax on worldwide income that year by taking a one-off 30+ day leave from China, or by being outside of China for over 90 days.

An individual can reset the five year count only if they have resided for less than 90 days in China during the year.

The "90 (183) days rule" does not apply if the employee in question holds a senior management position in China. Their director's fees or salaries paid by domestic employers, regardless of whether they are China or non-China sourced, are subject to IIT from the employee's first day in China.

“ Understanding the workings of value-added tax (VAT) in China is crucial to the success of any business, especially in terms of securing export refunds. This can be a challenge for US investors, who are typically unfamiliar with VAT systems. ”

Turnover taxes

Value-added tax (VAT)

VAT is one of two turnover taxes in China, the other being consumption tax. Previously, there was another turnover tax called business tax (BT) that was levied on goods and services at rates ranging from three to 20 percent. However, to avoid double taxation and support its modern services industry, China launched a pilot program in 2012 replacing BT with VAT for select industries, which was subsequently expanded nationwide in mid-2013. By May 1, 2016, the VAT reform was completed with Caishui [2016] No.36 coming into effect, although BT may still be in the course of being phased out in certain industries.

Value-added tax is considered a neutral tax, allowing businesses to offset VAT incurred in relevant purchases from their VAT liability. VAT taxpayers are categorized into general taxpayers and small-scale taxpayers based on their annual taxable sales amount. Taxpayers with annual taxable sales exceeding the annual sales ceiling set for small-scale taxpayers must apply for general taxpayer status. The sales ceilings are:

- RMB 500,000 for industrial taxpayers, i.e. enterprises engaged primarily in the manufacture of goods or provision of taxable services;
- RMB 800,000 for commercial taxpayers, i.e. enterprises engaged in the wholesale or retail of goods; and,
- RMB 5 million for VAT reform taxpayers.

VAT payers whose annual taxable sales are below the ceiling, as well as those who have newly established their business, can voluntarily apply for general taxpayer recognition upon meeting the following conditions:

- Possess a fixed place of business; and,
- Be capable of setting up legitimate, valid, and accurate bookkeeping.

Additional “soft” or unwritten requirements are also commonly found to influence the local tax authorities’ judgment on whether or not an applicant is eligible for general taxpayer status, such as registered capital, office size, and number of employees.

A company must obtain VAT general taxpayer status in order to be able to issue fapiao – a key requirement for conducting business with many Chinese suppliers and clients.

Small-scale taxpayers are subject to a lower uniform VAT levy rate of three percent, as compared to rates ranging from six to 17 percent for general taxpayers, but they cannot credit input VAT from output VAT, nor are they entitled to VAT export exemptions and refunds.

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.

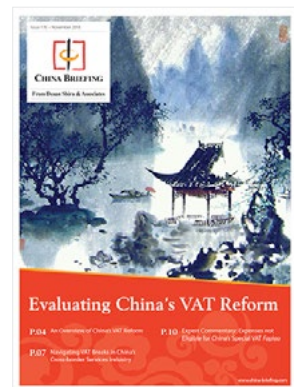
For general taxpayers, the basic formula for calculating VAT payable is:

$$\text{VAT PAYABLE} = \text{OUTPUT VAT IN THE CURRENT PERIOD} - \text{INPUT VAT IN THE CURRENT PERIOD}$$

If the output tax for the current period is insufficient to offset the input tax of the current period, the difference can be carried forward to the next term for continued offset.



RELATED READINGS



Evaluating China's VAT Reform November 2016

At the beginning of 2012, China began a massive overhaul of its tax system by initiating the replacement of business tax (BT) with value-added tax (VAT). As of May 2016, VAT has taken over almost all of BT's various functions, and is now effectively China's only form of consumption tax. In this edition of China Briefing, we walk readers through some of the most salient aspects of the VAT reform affecting foreign businesses in China.

AVAILABLE HERE

For small-scale taxpayers, the formula for determining VAT payable is:

$$\text{VAT} = \text{SALES} \times \text{VAT LEVY RATE}$$

$$\text{SALES} = \frac{\text{SALES INCLUDING VAT}}{(1 + \text{VAT LEVY RATE})}$$

Original VAT Rates

Taxable items	Rate
Export of goods (except where otherwise stipulated by the State)	0%
Sales and import of the following:	
<ul style="list-style-type: none"> • Cereals and edible vegetable oils • Tap water, heating, cooling, hot water, coal gas, liquefied petroleum gas, natural gas, methane gas, coal/charcoal products for household use • Books, newspapers, magazines (excluding newspapers and magazines distributed by the Post Department) • Feed, chemical fertilizers, agricultural chemicals, agricultural machinery and plastic covering film for farming • Agriculture, forestry, products of animal husbandry, aquatic products • Audio-visual products • Electronic publications • Dimethyl ether • Edible salt 	13%
Sale and import of goods other than those listed above; processing, repairs and replacement services	17%



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VAT Reform Rates

Taxable items	Rate
Tangible property leasing services:	
• Financial leasing	17%
• Operations leasing	
Transportation services:	
• Land transportation services (including railway transportation services)	11%
• Water transportation services	
• Air transportation services (including space transportation services)	
• Pipeline transportation services	
Financial services	
Insurance services	
Life services	
Value-added telecom services	
Research, development, and technological services	
Information technology services	6%
Culture and creative services	
Logistic auxiliary services	
Authentication and consulting services	
Radio, film and television services	
Cross-border taxable acts	0%

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. 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.

Consumption Tax Rates (A)

Taxable items	Tax rate	Comments
Tobacco		
• Grade A cigarettes	56% plus RMB 0.003 per cigarette	
• Grade B cigarettes	36% plus RMB 0.003 per cigarette	
• Wholesale	11% plus RMB 0.005 per cigarette	Increased from May 10, 2015
• Cigars	36%	
• Cut tobacco	30%	
Alcohol		
• White spirits	20% plus RMB 0.5 per 500g/ml	
• Yellow spirits	RMB 240/ton	
• Beer	Type A: RMB 250/ton Type B: RMB 220/ton	
• Other alcoholic drinks	10%	
Precious jewelry and precious jade and stones	<ul style="list-style-type: none"> • Gold, silver, platinum and diamonds: 5% • Other precious jewelry and precious jade and stones: 10% 	Includes all kinds of gold, silver, jewelry and precious stone ornaments
Firecrackers and fireworks	15%	
Gasoline		
• Passenger cars, with a cylinder capacity of		
» 1.5 liters and below	1 liter and below: 1% 1 to 1.5 liters: 3%	
» 1.5 to 2 liters	5%	
» 2 to 2.5 liters	9%	
» 2.5 to 3 liters	12%	
» 3 to 4 liters	25%	
» Above 4 liters	40%	
• Small-to-medium size commercial vehicles (e.g. cross country vehicles, minibuses and vans)	5%	
• Ultra-luxury cars	1-40% depending on cylinder capacity for passenger cars, 5% for commercial vehicles in production process, plus an additional 10% for retail	Starting from December 1, 2016

Consumption Tax Rates (B)

Taxable items	Tax rate	Comments
Motorcycles, with a cylinder capacity of:		
• 250 ml	3%	
• Over 250 ml	10%	
High-end cosmetics & skincare products where the selling price/customs value (excluding VAT) at the production/import stage is at least RMB 10/ml (g) or RMB 15/pc	15%	Starting from October 1, 2016
Golf balls and equipment	10%	
Luxury watches	20%	
Yachts	10%	
Disposable wooden chopsticks	5%	
Solid wood flooring	5%	
Petroleum oil		The tax rate has increased multiple times
• Naphtha	RMB 1.52/liter	
• Solvent oil	RMB 1.52/liter	
• Lubricant oil	RMB 1.52/liter	
• Diesel oil	RMB 1.2/liter	
• Fuel oil	RMB 1.2/liter	
• Aviation oil	RMB 1.2/liter	Temporary exemption
Lead battery (Mercury-free battery, nickel- metal hydride battery, lithium ion battery, lithium battery, solar cells, fuel cells and whole vanadium flow battery shall be exempted from CT)	4%	Starting from January 1, 2016
Paint (Paints with Volatile Organic Compounds (VOC) of less than or equal to 420 g/l shall be exempted from the CT)	4%	Starting from January 1, 2016



Other taxes

Withholding tax

Withholding tax is a PRC tax levied on passive income (i.e., dividends, bonuses, other equity investment gains, interests, rentals, royalties, transfer of property) received by non-resident enterprises from China. The withholding income tax rate is currently 10 percent. If a foreign party is a tax resident of a country or jurisdiction that has entered into a double tax treaty with China that includes reduced withholding tax, the foreign party can enjoy these reduced rates upon approval from the designated tax bureau. The China enterprise remitting the fund overseas should be the withholding agent.

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 or CT are also subject to urban construction and maintenance taxes (UCMT), education surcharge (ES) and local education surcharge (LES).

- UCMT rates are seven percent for urban areas, five percent for counties (towns), and one percent for other regions.
- The ES rate is three percent regardless of location.
- The LES rate is two percent regardless of location.
- Together, these surcharges amount to 12 percent of a company's total turnover tax liability (i.e., VAT and CT) 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).

Urban and township land use tax

Individuals and enterprises that use land in cities and towns are subject to urban and township land use tax. The taxable amount per square meter for land use tax is as follows:

- RMB 1.5 to RMB 30 for large cities;
- RMB 1.2 to RMB 24 for medium cities;
- RMB 0.9 to RMB 18 for small cities; and,
- RMB 0.6 to RMB 12 for county towns, towns and industrial and mining areas.

Local governments have the right to increase or reduce the tax rate according to their socioeconomic conditions. However, the reduction amount may not exceed 30 percent of the minimum level.

Land appreciation tax

All organizations and individuals who transfer state-owned land use rights, buildings and other structures on that land, and who earn income from the transfer, should pay land appreciation tax in accordance with relevant laws and regulations.

Calculation of land appreciation tax is based on the appreciation amount gained by the taxpayer through the transfer of real estate (i.e., the balance of the proceeds received by the taxpayer on the transfer of real estate after deducting the sum of deductible items), and should be levied in accordance with a four-step progressive tax rate based on the percentage amount by which the appreciation amount is in excess of the amount of deducted items.

Land Appreciation Tax Rate Levels

Level	Appreciation/deduction	Tax rate	Quick deduction
1	≤50%	30%	0%
2	> 50% and ≤100%	40%	5%
3	> 100% and ≤200%	50%	15%
4	> 200%	60%	35%

The deductible items include:

- Amount of funds paid to obtain land use rights;
- Costs and expenses incurred in the development of the land; and,
- Tax related to the transfer of real estate and other items to be deducted as stipulated by the MOF.



Resource tax

Companies or individuals engaged in the exploitation of certain mineral resources or salt production are liable for resource tax, which was originally calculated ad valorem or based on quantity.

In 2010, China initiated a resource tax reform on crude oil and natural gas in northwestern Xinjiang, and later extended this nationwide in 2011 after two delayed launches. The reform, ostensibly for the promotion of resource conservation, stipulates that natural resources such as coal and natural gas will be taxed based on the resource price rather than quantity. On December 1, 2014, China extended its sales value-based resource tax reform to the coal industry. On July 1, 2016, China began a comprehensive reform of the resource tax system to modernize and strengthen China's approach to other natural resources as well.

Under the reform, most mineral products (except clay and sandstone) will be taxed based on its sales price at a rate ranging from one percent to 20 percent as set by the provincial governments according to local socioeconomic conditions. But the tax rates will remain the same for resources that are already included in the 2010 reform such as crude oil, natural gas, coal, rare earth, tungsten and molybdenum. Besides, a pilot reform of water resource taxation will be implemented in the province of Hebei, changing water resource fees into a taxation system. If proven successful, the water resource taxation reform will be further expanded to cover other provinces, and other types of resources that are sourced from forests, grasslands and tidal mudflats shall be included in the collection scheme. The reform also provides some preferential policies for certain resources and mining projects. For example, resources obtained by backfill mining methods shall enjoy a 50 percent reduction on resource tax, and resources derived from exhaustion stage mines and low abundance oilfields will enjoy a 30 percent reduction on resource tax. Meanwhile, it was made clear that all funding and charges related to mineral resources will be cancelled by the reform.

Vehicle and vessel tax

Owners or administrators of certain types of vehicles and vessels are subject to vehicle and vessel tax. Preferential policies are available for energy-saving vehicles/vessels or vehicles/vessels using new energy technology. Tax exemptions may be applied to diplomatic vehicles and vessels. According to the Caishui [2015] No.51, released by the SAT in May 2015, eligible energy-saving vehicles/vessels can enjoy a half-reduced tax rate, and eligible new energy vehicles/vessels can be exempt from vehicle and vessel tax. Automobile manufacturers and importers who are engaged in making or importing qualified vehicles may apply to the Ministry of Industry and Information Technology (MIIT) for the tax incentives.

What are some of the key compliance requirements?



AMBER LIU

Senior Manager
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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 MOF in 2006 and partly revised in 2014, are broadly in line with the International Financial Reporting Standards. 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 FIE's taxable and distributable profit.

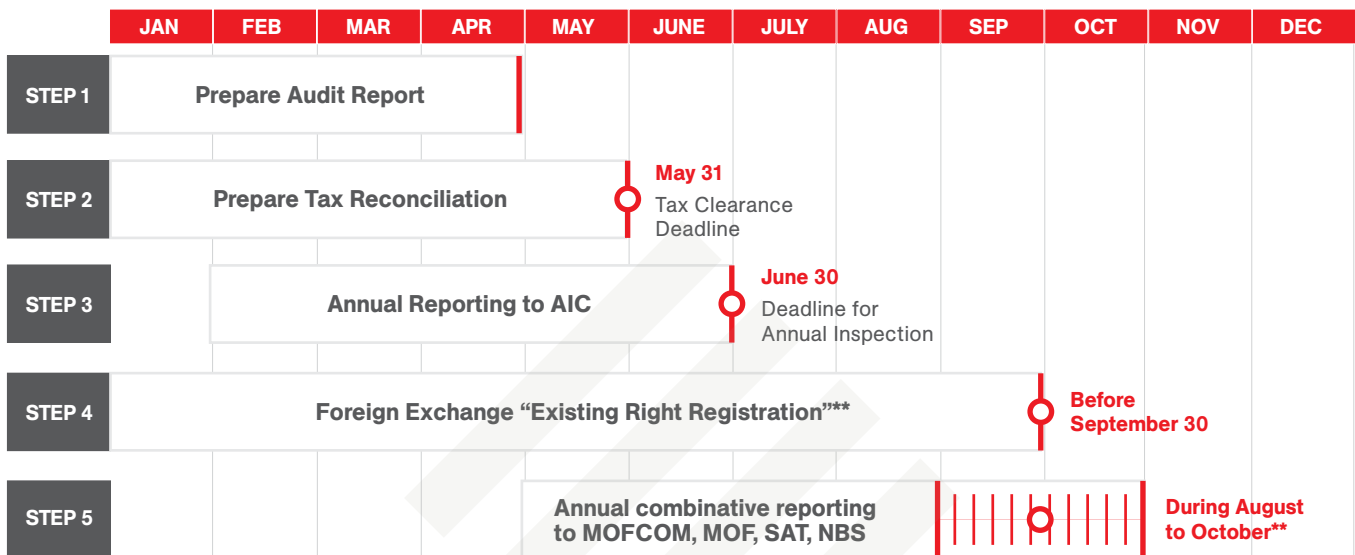
Books and records have to be retained for at least 10 years under Chinese law. By law, any business transactions carried out in mainland China require a fapiao. In practice, a significant portion of small to medium-sized companies conduct certain sales under the table out of reluctance to part with their fapiao. This is because 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 the following steps: producing a statutory annual audit report, a CIT reconciliation report, making "existing right registration" for foreign currency reconciliation, and reporting to relevant government bureaus. 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. Companies should either contact a service provider or the local government to achieve full compliance.

“ 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. ”

Annual Compliance Timeline*



*Subject to regional variation

**Subject to yearly variance

• Step 1 - Prepare a statutory annual audit report

The statutory annual audit report consists of a balance sheet, an income statement and a cash flow statement. To ensure that foreign invested companies meet Chinese financial and accounting standards, including proper use of China GAAP, the annual audit report must be conducted by external licensed accounting firms and signed by a Certified Public Accountant (CPA) registered in China for compliance purposes.

The requirements for the audit report vary by region. For instance, in Shanghai, companies must include a taxable income adjustment sheet in the audit report, which is not a necessary supplement in Hangzhou, Beijing or Shenzhen. The audit procedure takes about two months, and the audit report should be completed before the end of April in order to meet the May 31 tax reconciliation deadline.

- **Step 2 - Prepare CIT reconciliation report (annual tax returns)**

In China, CIT is paid on a monthly or quarterly basis in accordance with the figures shown in the accounting books of the company; companies are required to file CIT returns within 15 days from the end of the month or quarter. However, due to discrepancies between China's accounting standards and tax laws, the actual CIT taxable income is usually different from the total profits shown in the accounting books. As such, the State Administration of Taxation (SAT) requires companies to submit an Annual CIT Reconciliation Report within five months from the previous year's year-end to determine if all tax liabilities have been met, and whether the company needs to pay supplementary tax or apply for a tax reimbursement. Generally, the Annual CIT Reconciliation Report must include adjustment sheets to bridge the discrepancies between tax laws and accounting standards.

Every year around March, depending on the area, the local Tax Bureau will issue annual guidance on CIT reconciliation. The Annual CIT Reconciliation Report is examined by the Tax Bureau to see if all tax liabilities have been fulfilled under tax law. Adjustments in financial statements caused by discrepancies between Tax Law and accounting standards are also required to be included in the Annual CIT Reconciliation Report. FIEs that additionally conduct frequent transactions with related parties should prepare an Annual Affiliated Transaction Report on transfer pricing issues as a supplementary document to the Annual CIT Reconciliation Report.

Moreover, FIEs in certain regions need to engage a Certified Tax Agent firm in China to prepare another separate CIT audit report. In Beijing, this requirement applies to firms that meet the following conditions:

- » Yearly sales revenue exceeds RMB 30 million;
- » Carrying over last year's losses to deduct this year's income; or,
- » Yearly losses exceed RMB 100,000.

In Shanghai, the CIT audit report is needed when:

- » Tax payers who have made a loss (current year loss) of more than RMB five million; or,
- » Tax payers who have offset losses carried forward from previous years.

The deadline for submitting the CIT Reconciliation Report to the Tax Bureau is May 31 every year, but the investigation of the tax compliance could last to the end of the year, and companies should be prepared to provide supporting documents upon demand from the Tax Bureau.

• **Step 3 - Annual reporting to AIC**

According to the “Interim Regulations for the Publicity of Corporate Information”, each year from January 1 to June 30, all FIEs should submit an annual report for the previous fiscal year to the relevant AIC. This should be done through the corporate credit and information publicity system.

The annual report submitted should cover the following information:

- » The mailing address, post code, telephone number and email address of the enterprise;
- » Information regarding the existence status of the enterprise;
- » Information relating to any investment by the enterprise to establish companies or purchase equity rights;
- » Information regarding the subscribed and paid in amount, time, and ways of contribution of the shareholders or promoters thereof, in the case that the enterprise is a limited liability company or a company limited by shares;
- » Equity change information of the equity transfer by the shareholders of a limited liability company;
- » The name and URL of the website of the enterprise and of its online shops; and,
- » Information of the number of business practitioners, total assets, total liabilities, warranties and guarantees provided for other entities, total owner’s equity, total revenue, income from the main business, gross profit, net profit, and total tax.

• **Step 4 - Annual foreign exchange reconciliation**

All foreign exchange transactions in and out of China are strictly controlled by SAFE, the bureau under the central bank of China (the People’s Bank of China), that drafts rules and regulations governing foreign exchange and market activities, as well as supervises and inspects foreign exchange transactions.

Previously, SAFE required that all FIEs complete a Statement of Foreign Investors’ Equity to demonstrate the legality of their foreign currency inflow and outflow, and hire an authorized Chinese CPA firm to issue a Foreign Exchange Annual Inspection Report. However, according to the “Notice on Further Simplifying and Improving the Foreign Exchange Management Policies for Direct Investment” (Hui Fa [2015] No.13), effective since June 1, 2015, the foreign exchange annual inspection for direct investment has been canceled. In its place, relevant market players are required to make an “Existing Right Registration” before September 30 each year. Failure to comply with the registration requirements results in the foreign exchange bureaus taking control over the parties in the capital account information system. Further, banks will not carry out foreign exchange business under the capital account for offending companies.

- **Step 5 - Annual combinative reporting to MOFCOM, MOF, SAT and NBS**

FIEs in China have been required to undergo an Annual Combinative Inspection jointly conducted by several governmental departments since 1998. However, pursuant to a Notice jointly released by MOFCOM, MOF, AIC, SAT, SAFE and NBS in 2014, the annual combinative inspection has now been replaced by an annual combinative reporting system. Unlike the annual inspection, annual reporting entails that relevant government bureaus take on the role of supervisors rather than judges. They no longer have the right to disapprove reports that are submitted, even if they think the reports are unqualified – they can only suggest that the FIEs make modifications. Accordingly, relevant government bureaus no longer affix any seals on a report.

With this new rule implemented, the annual compliance requirements for FIEs have become much more manageable. All information can be submitted online and paper materials are no longer required.

The deadline for this combinative report is subject to yearly variance. In 2014, it was June 30, but it has been extended to October 30 for 2015. In 2016, the reporting period was from May 16 to August 31.

For ROs, annual compliance procedures are simpler. While ROs are exempt from cooperative annual inspection, they need to prepare a statutory audit report and a tax reconciliation report, and then report to AIC.

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, and 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 towards 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. However, it can also include market, reputational and cultural considerations. A due diligence checklist in China is generally quite similar to those used elsewhere, likely including a 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); and,
- 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 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.



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. ”

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). To safeguard against fraud, 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 different purposes 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.

Transfer pricing

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.

In China, the relationship threshold for transfer pricing rules to apply between parties is low 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, all resident enterprises under the scheme of tax assessment by accounts inspection and non-resident enterprises establishing organizations or premises in China, should submit the “Enterprise Annual Reporting Forms for Related Party Transactions of the People’s Republic of China”, which in total consists of 22 separate forms as of 2016. 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 only transact with domestic related parties) should prepare and maintain a contemporaneous transfer pricing documentation, 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 30 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.



SHIRLEY CHU

Manager

Corporate Accounting Services
Dalian Office

“ If done properly, transfer pricing can save a foreign investor a substantial amount on their tax bill. However, careful planning is advised: transfer pricing transactions are under special scrutiny. In case of non-compliance, the back taxes and penalties can be severe. ”



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



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?

In China, the company can hire employees in the following three ways:

1. Direct hiring
2. Dispatching
3. Outsourcing

Direct hiring

Except for ROs, FIEs can hire employees directly by themselves. The Chinese Labor Law requires employers to sign a written contract with their employees within one month, starting from the employee's first day of work at the company. Failing to do so results in double salary compensation (for each month without a contract), and a non-fixed term contract by default (after one year without a contract). One exception to this rule is part time work, where an oral agreement is considered sufficient.

Generally, China allows three types of employment contracts:

- Fixed-term contract
- Non-fixed term contract
- Job contract

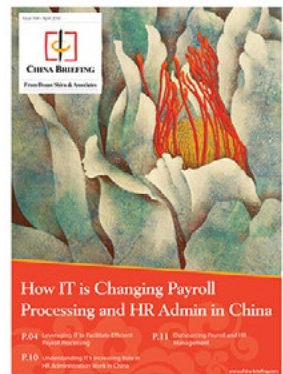
Fixed-term contract

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 fixed-term contract can be renewed only once, after which it will be necessary to give the employee a non-fixed term contract when renewing for a second time. Certain clauses may be inadmissible according to Chinese law, while others are mandatory. 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. Also, the employer is allowed to pay the employee 80 percent of the full salary stated in the employment contract, although this amount may not fall below the local minimum wage. The employee may resign after giving only three days' notice. It is therefore inadvisable to stipulate a very long probation period. The length of the fixed-term contract will determine the maximum length of probation the employer can set.

During the probation period, the employer may dismiss the employee if he/she is found to not meet the requirements for the position. The burden is on the employer to prove this.



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ADAM LIVERMORE

Partner
Dalian Office

Maximum Probation Period by Contract Term

Contract term	Maximum probation period
Less than 3 months	None
3 months to 1 year	1 month
1 – 3 years	2 months
3+ years or non-fixed term contract	6 months

Note: An employer cannot make an employee take a new probation period, for example, after promotion or when the company has been merged or acquired by an investor.

For part-time workers:

- 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 are not required to have a written contract.

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-fixed 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. During a mass lay-off, employees on non-fixed term contracts must be prioritized over other employees.

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.

“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.”

Dispatch

Labor dispatch is an alternative option for FIEs looking to hire Chinese staff. While the preparatory work often requires the assistance of Chinese employees, FIEs are not allowed to establish legal contracts with Chinese individuals before they obtain their business license. Additionally, as mentioned previously, an RO cannot hire staff directly, and their employees must be seconded from dispatch agencies.

Labor dispatching arrangements are only applicable for the following three types of positions:

- Temporary position: a position with duration of no more than six months.
- Auxiliary position: a position that provides auxiliary services to the main or core business of the employer.
- Replaceable position: a position that can be performed by a dispatched employee in place of a permanent employee during the period when such an employee is away from work for study, vacation, or other reasons.

The number of total dispatched employees used by an employer should not exceed 10 percent of its total number of employees, including regular employees and dispatched employees. ROs of foreign enterprises, however, are not subject to this restriction on dispatched employees' positions.

In addition, there must be a contract between the dispatching company and the dispatched employee, the dispatching company and the FIE, as well as the dispatched employee and the FIE, respectively. The contract between the dispatching company and the dispatched employee should have a fixed term of at least two years.

Outsourcing

Outsourcing is an additional option for FIEs. Generally, the most commonly outsourced tasks are those that require specialist skills, a high degree of confidentiality, or those that have a clear scope, but incur major consequences if incorrectly implemented. Good examples in China include accounting, tax filing, HR administration and payroll processing work. Many small and medium-sized companies will choose to completely outsource some or all of these functions, whereas large companies will set up a separate entity to manage such back-office tasks on behalf of their regional subsidiaries.



- Responsibility for the behavior of the outsourced employee is borne by the company contracted for the outsourcing.
- The role is often not a full-time one, and most of the work does not have to be completed on-site. Working off-site improves the level of confidentiality. As the company does not need to hire a full-time internal resource for the role, outsourcing can often be a money-saving solution.
- The outsourcing company retains the right to use whichever resources it feels are best for each project. This ensures continuity in service provision.
- Such tasks will often use special software licensed by the company contracted for the outsourcing.



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**

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; and,
- » 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**

The R visa is a relatively new type of 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.

Types of Visas and Purposes

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 and 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

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?



HELEN KONG

Manager

HR Administration & Payroll Services
Dalian Office

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.


Overtime

In China, overtime is paid differently depending on the work hour system adopted by the employer, by either standard work hours, comprehensive work hours or non-fixed work hours. Note that comprehensive and non-fixed work hour systems 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.

“ 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. ”



In total, there are five social security funds:

- Pension;
- Unemployment;
- Medical;
- Occupational injury; and,
- 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 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 Benefit Types



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.



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.



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.



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.



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).



Housing Fund

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

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 2016, many cities announced plans on temporarily reducing social security contribution rates to save costs for enterprises. FIEs should follow the local rates when calculating payroll and paying mandatory contributions for the social security of their employees.

Social Security Fund Contributions

Fund	Approximate contribution (% of employee'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

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 HR 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.

Termination



LINA WANG

Manager
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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 full compliance:

- **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 are 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 additional severance payment might be required.

“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.”

Terminating Staff in China - an Overview

Type of termination	Admissible grounds	Type of employee	Severance payment
During probation	<ul style="list-style-type: none"> Employee doesn't meet the job requirements stated in job description 	<ul style="list-style-type: none"> Fixed-term Non-fixed term 	No
Mutual agreement	<ul style="list-style-type: none"> Agreed with employee 	<ul style="list-style-type: none"> Fixed-term Non-fixed term 	Yes (if the termination is put forward by the employer)
Immediate (unilaterally)	<ul style="list-style-type: none"> Serious violation of company rules Serious loss attributed to employee Giving false information to employer Criminal offense during employment Employee takes up second job, harming first employer 	<ul style="list-style-type: none"> Fixed-term Non-fixed term 	No
30 days' notice (unilaterally)	<ul style="list-style-type: none"> Employee incompetent for position Employee unable to work after sickness/injury Job cannot be performed due to fundamental change in objective circumstances 	<ul style="list-style-type: none"> Fixed-term Non-fixed term 	Yes
Not renewing contract	<ul style="list-style-type: none"> After one or two fixed-term contracts, differs per city 	<ul style="list-style-type: none"> Fixed-term 	Yes (unless the employee refuses to renew the contract upon maintained or raised provision proposed by the employer)
Mass lay-off	<ul style="list-style-type: none"> Company being restructured under the PRC Enterprise Bankruptcy Law Serious difficulties in productions or operations Company changes production method, making staff unnecessary Objective economic situation makes employment impossible 	<ul style="list-style-type: none"> Fixed-term Non-fixed term 	Yes
Automatic termination upon bankruptcy/ revoke/dissolution	<ul style="list-style-type: none"> The employer is declared bankrupt pursuant to the law The employer's business license is revoked The employer is ordered to close down The employer has decided to dissolve prematurely 	<ul style="list-style-type: none"> Fixed-term Non-fixed term 	Yes
Termination not allowed (under most situations)	<ul style="list-style-type: none"> The employee is suspected of having occupational disease(s) and waiting for diagnosis. The employee has completely or partially lost labor capability due to occupational disease(s) or work injury. The employee is still in the legal recuperation period for non-work-related illness/ injury. The employee is pregnant, on maternity leave or in nursing period. The employee has continuously worked for the employer for more than 15 years and is less than five years before retirement. 		

Note: When unilaterally terminating an employee, the employer needs to notify the labor union if there is one.



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