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Doing Business in

China

Mar 2011



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Contents

- 2 Introduction
- 2 About JHI
- 3 JHI in China
- 4 Key Facts
- 6 Taxation in China
- 11 VAT and Customs Duty
- 12 Foreign Investment
- 13 Immigration to China
- 15 Establishing a Business in China
- 17 Commercial and Residential Property
- 19 Employment in China

Introduction

This guide is written for foreign companies and individuals interested in doing business in China. It outlines key facts and figures on China's economy, business infrastructure, laws and taxation. This information contained herein is for guidance only and no responsibility for loss from action taken based on any material herein can be accepted. It is recommended readers obtain further information and professional advice prior to making any decision.

About JHI

JHI is a flourishing worldwide network of approximately 130 member firms in 55 countries. The largest association of its kind, JHI exists to enhance the ability of member firms and their clients to drive business locally and internationally through a variety of distinctive programs and services.

Its members are respected leaders, offering a broad range of accounting, auditing and management consultancy services in every business sector. They play key roles in setting the course for the profession. This extends to JHI members who serve in leading positions with worldwide bodies such as the Forum of Firms, an organization of international firms that perform audits of financial statements that are, or may be, used across national borders. Potential new members are subject to a rigorous selection process based on criteria including the quality of practice, reputation and geographical location.



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Doing Business in China



JHI in China

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Doing Business in China



Key Facts

Population: 1.33 billion
(mid-2007)

Currency: Renminbi (RMB).
Not freely convertible in
other
international
exchange
markets except
Hong Kong

Dialling Code: +86

Language: Putonghua is
the official
language

Fiscal Year: 1 Jan - 31 Dec

Time Zone: China Time
Standard Time
is 8 hours
ahead GMT
(GMT+8).

Business hours:

Five-day work week with no more than 8
hours a day and no more than 44 hours
a week as per Labor Law

Public holidays:

Normally 11 public holidays, including
New Year's Day, Spring Festival, Labor
Day, National Day, Qingming Festival,
Dragon Boat Festival and Mid-Autumn
Festival when all Chinese people will be
on vacation. For spring Festival and
National Day, the holidays will normally
be for at least 7 days.

Political Context

China has delegates from 23 provinces,
4 municipalities, 5 autonomous regions and
2 special administrative regions (Hong Kong and
Macao).

Doing Business in China

Economy

Gross Domestic Product per capita: In the year of 2010, Chinese GDP reached 39,798 billion RMB (6,009.4 billion USD), the world's second largest economy after US.

Major industries: Textiles, fuel and energy resources, agriculture and light industry.

Major imports: Steel, chemicals, machinery, vehicles, aircrafts, energy sources, minerals and oil products.

Major exports: Textiles, agriculture, toys, machinery, and high-tech related goods.

Principal trading partners: European Union, United States, Japan, Association of South-East Asian Nations (ASEAN), South Korea, Russia, Australia and India.

Legal and Judicial System

The National People's Congress (NPC) of the People's Republic of China is the highest organ of state power. The Standing Committee of the NPC is the permanent organ of the NPC. The term of office of the NPC and its Standing Committee is five years. The NPC and its Standing Committee are empowered with the rights of legislation, decision, supervision, election and removal of members.

The State Council of the People's Republic of China, namely the Central People's Government, is the highest executive organ of the State power, as well as the highest organ of State administration. The State Council

is composed of a premier, vice-premiers, State councilors, ministers in charge of ministries and commissions, the audit-general and the secretary-general. The premier of the State Council is nominated by the president of Communist Party, reviewed by the NPC, and appointed and removed by the president. Other members of the State Council are nominated by the premier, reviewed by the NPC or its Standing Committee, and appointed and removed by the president. In the State Council, a single term of each office is five years, and incumbents cannot be reappointed after two successive terms.



Taxation in China

Corporate Income Tax

Foreign invested commercial enterprises are subject to Corporate Income Tax ("CIT") at a standard rate of 25%. Small-scale enterprises with minimal profits that are qualified are subject to the applicable enterprise income tax rate with a reduction of 20%. Small-scale enterprises refer to enterprises engaging in industries not restricted or prohibited by the State and fulfilling the following conditions:

- For industrial enterprises, the annual taxable income does not exceed RMB 300,000; the number of employees does not exceed 100 and the total assets does not exceed RMB 30 million;

- For other enterprises, the annual taxable income does not exceed RMB 300,000; the number of employees does not exceed 80 and the total assets does not exceed RMB 10 million.

If a Foreign Enterprise (FE) without an establishment in China derives income in the nature of interest, rent and royalties, it will be subject to Business Tax (BT) and withholding CIT at a standard rate of 10% under the CIT law (unless a double tax treaty/arrangement applies).

Calculating Taxable Income

The taxable income of a TRE in China shall be the amount of gross income (which includes sales, service income, transfer of assets, dividends from equity investment, interest income, rental, royalties and donations) in a calendar year, less costs, losses, reasonable expenses and expenses related to the production of taxable income. Reasonable expenses

include all necessary and normal expenses in relation to the ordinary business activities.

rent and royalties, it will be subject to Business Tax (BT) and withholding CIT at a standard rate of 10% under the CIT law (unless a double tax treaty/arrangement applies).

Deduction Limits

In arriving at the taxable income, deductibility of certain expense items may be limited as laid out below:

- Commercial insurance premiums, paid for employees, are generally not deductible unless approved by the relevant authorities in China;
- Employee welfare expenses are deductible subject to a cap of 14% on total annual salaries and wages;
- Expenditure on labor union is deductible subject to a cap of 2% on total annual salaries and wages;
- Employee education expenses are deductible subject to a cap of 2.5% on total annual salaries and wages; any remaining amount not deducted in the fiscal year can be carried forward for tax deduction in future years;
- 60% of the entertainment expenses incurred in business operations are deductible subject to a cap of 0.5% on annual sales/turnover;
- Advertising and promotion expenses are deductible subject to a cap of 15% on annual sales/turnover; any remaining amount not deducted in the fiscal year can be carried forward for tax deduction in future years;
- Inter-company management fees, inter-company rental expenses and royalty payments, and intercompany interests within non-financial institutions are not deductible;
- Donations made to approved charitable organizations are deductible subject to a cap of 12% on annual accounting profit;
- Sponsorship expenses which are not advertising in nature and which are not related to the production and business operations are not deductible;
- Income taxes, local taxes and additional taxes are not deductible;
- Penalties and surcharges are not deductible;
- The costs of intangible assets such as patents, trademark etc. can be amortised;
- Interests on loans from non-financial institutions are deductible up to the normal interest rate offered by commercial banks; interest expenses for loans from related companies in excess of a prescribed debt-equity ratio are disallowed.

Inter-company Transfers

5% Business Tax (BT) and 10% withholding CIT would be imposed on gross amount of passive income (such as interest, royalties and rental). For active businesses (such as consulting, training) carried out by foreign entities in China are subject to BT at 5% on total income and CIT at 25% on net profits. A deemed profit rate of 15% to 50% (usually 15% to 20% in most cases) of the gross income is applied to derive the net profits.

An increase of deemed profit rate was published in a tax regulation of Guoshuifa [2010] No. 19 ("Circular 19") which was issued by the State Administration of Taxation ("SAT") on February 20, 2010. Circular 19 provides the range of deemed profit rates to be applied for different

types of businesses. It has increased deemed profit rates from a generally adopted range of 10%–40% to 15%–50%. The new deemed profit rates are as follows:

- a. Construction and engineering projects, design and consulting: 15%–30%
- b. Management services: 30%–50%
- c. Other services: not less than 15%

The new CIT law states that related party transaction shall be at arm's length and is required to be disclosed in corporate income tax annual return. The tax authority has the right to make tax adjustments if the transaction is considered non-arm's length.

Depreciation

Fixed assets are classified into five categories and depreciated on a straight-line basis for a prescribed

minimum period with a reasonably estimated residual value.

Fixed asset types	Minimum depreciation period
Buildings and structures	20
Production equipment, aircrafts, trains, vessels and machinery	10
Tools, appliances and furniture, etc. related to production and business operation	5
Transportation equipment other than aircrafts, trains and vessels	4
Electronic equipment	3

Accelerated depreciation is allowed on certain fixed assets, including fixed assets subject to rapid technological changes and those exposed to constant

shocks and erosion. The minimum years of depreciation must be at least 60% of the abovementioned depreciation period.

Provisions

Provisions are generally not deductible.

Corporate Income Tax Rates

The standard CIT rate is 25%.

Small-scale enterprises with minimal profits that are qualified are subject to the applicable enterprise income tax rate with a reduction to 20%. Small-scale enterprises refer to enterprises engaging in industries not restricted or prohibited by the State and fulfilling the following conditions:

- For manufacturing type of enterprises, the annual taxable income does not exceed RMB 300,000; the

number of employees does not exceed 100 and the total assets does not exceed RMB 30 million;

- For other enterprises, the annual taxable income does not exceed RMB 300,000; the number of employees does not exceed 80 and the total assets does not exceed RMB 10 million.

Carrying Losses Forward

Tax losses can be carried forward for a period of not more than five years to offset against future taxable income.

Carry Back Rules

Tax losses cannot be carried back.

Groups of Companies

There is no group relief.

Repatriation of Profits

Dividend should be subject to withholding CIT at a standard rate of 10% under CIT law (unless a double tax treaty/arrangement applies).

No Tax Obstacles to Invoicing Interest, Royalties or Management Fees

Intercompany management fees, intra-company rental expenses and royalty payments, and

intercompany interests within non-financial institutions are not deductible.

Generous Exemptions for Dividends Paid Through Holding Companies

Dividend should be subject to withholding CIT at a standard rate of 10% under CIT law (unless a double tax treaty/arrangement applies).

Special Rules for Headquarters and Logistics Centres

There is no special rule of CIT for headquarters and ordinary logistics centres.

For Business Tax (BT), under the BT law, transportation companies shall pay BT on the

balance of the total price and other price and charges less the payments made to other units or individual, if they subcontract their transport work to other units or individuals.

Taxation on Representative Office (“RO”)

The SAT issued a tax regulation of Guoshuifa [2010] No. 18 (“Circular 18”) on February 20, 2010 related to the tax administration on ROs in China. Circular 18, which abolishes previous tax administration on ROs, with effective date of January 1, 2010 retrospectively, provides certain new tax policies on ROs:

- ROs should submit quarterly CIT returns based on actual taxable profits and quarterly business tax (“BT”) returns based on actual taxable revenue within 15 days after the end of each quarter, and submit value-added tax (“VAT”) returns and pay VAT in accordance with the deadlines stipulated in the VAT laws and its implementation rules;
- Local tax bureaus should no longer accept applications for CIT exemption and they should clear the taxabilities of ROs that were verified to be exempt from CIT by the local tax bureaus under old regulations.
- If ROs cannot provide complete accounting records or if they cannot accurately calculate their turnover and expenses (actual amount method), the tax authorities can use one of the following methods to verify their taxable turnover and profits:
 - a. Cost plus method – for ROs that can provide their accurate expenditure, but cannot provide their correct turnover or cost;
 - b. The deemed profit method based on actual turnover – for ROs that can provide accurate turnover, but cannot provide their correct costs and expenses.



VAT and Customs Duty

Customs Duties

Goods imported into China will subject to value-added tax (VAT) at a standard rate of 17% and customs duty. The Customs Import and Export Tariff of the People's Republic of China, published by the Customs Tariff

Commission, provides detailed import and export duty rates for all goods and commodities. Both "general rates" and "most favoured nation rates" are shown for each category.

Clearance of Goods

All goods permitted to be imported into or exported out of or transshipment shall be declared to the Customs. Shippers could pick up the goods from the Customs after the various procedures (such as

examination, taxation, release) done by the Customs. All goods in the process of Customs Clearance should be under supervision by the Customs and should not be freely circulated.



Foreign Investment

Formalities for International Investors in China

On 31 October 2007, the National Development and Reform Commission and the Ministry of Commerce of the P. R. C. co-promulgated the 2007 Edition of Foreign Enterprise Investment Projects Instruction Catalogue ("the Catalogue"), which became effective on 1 December 2007. According to the Catalogue, all foreign investments can be categorized into three types, namely: encouraged industries; restricted industries and prohibited industries.

Incentives available to foreign investments that fall within "encouraged industries" are provided in regulations and circulars issued by the State

Administration of Taxation and other relevant authorities. These include customs and tax incentives and other preferential treatment.

Since Mainland China's accession to WTO and the introduction of Close Economic Partnership Arrangement with Hong Kong and Macau Special Administrative Region, more areas are opened gradually to investors from overseas and the two regions.



Immigration to China

China is not an immigrant country. No law or regulations are set permitting immigration. A foreigner is only allowed to reside here for reasons of work, study, travel, or marriage over a certain period of time.

Business Owner

Even a businessman setting up in business in China cannot immigrate to China. A businessman can be employed by the company he/she setting up in China

to apply for work permit and residence permit limited to 12 months, but renewable every year

Sole Representative

Even a sole representative of an overseas company cannot immigrate to China. She/he can be employed by the company in China to apply for work permit and

residence permit limited to 12 months, renewable every year.

Investor

Even an investor cannot immigrate to China. She/he can be employed by the company in China to apply for work

permit and residence permit limited to 12 months, but renewable every year.

Retired Persons

Retired persons of independent means can apply for visitor visa.

Dependants

Dependants like wife, children and parents are allowed to obtain residence permit that will be limited to the

period of expiry of the work permit of the person they depend on.

Work Permit Holders

It would not be difficult for foreign employees to obtain the work permit in China as long as he/she possesses

the right skill set and qualification (minimum university graduate).



Establishing a Business in China

The common forms of business establishment for foreign investors include:

- Equity joint venture
- Co-operative joint venture
- Wholly foreign-owned enterprise
- Representative office

Equity Joint Venture (EJV)

An equity joint venture is a limited liability Chinese legal entity formed by one or more Chinese parties and one or more foreign parties under the Sino-foreign Equity Joint Venture Enterprise Law. The liability of entity is limited by the registered capital. It is a distinct and separate taxable legal entity. Basically, at least 25% of the joint venture's

shareholding has to be held by foreign investor(s) for it to be considered an EJV. The joint venture will be managed by a board of directors with appointees from both sides. Investors in an equity joint venture share profits and losses strictly in accordance with their respective contributions to the registered capital of the venture.

Co-operative Joint Venture (CJV)

A co-operative joint venture is sometimes referred to as a contractual joint venture. The establishment of a co-operative joint venture is governed by the Sino-Foreign Co-operative Joint Venture Enterprise Law. It is formed as

a separate legal entity with limited liability by the registered capital, or an entity similar to a partnership. Investors in a co-operative joint venture share profits and losses in accordance with the agreed provisions in

Wholly Foreign-owned Enterprise (WFOE)

A wholly foreign owned enterprise is 100% owned by foreign investors. The establishment of a wholly foreign-owned enterprise is governed by the Foreign Enterprise Law. It is a distinct and separate taxable entity. It is

formed as a separate legal entity with limited liability by the registered capital. A WFOE can choose to have a board of directors or just one executive director to run the management of the WFOE.

Representative Office (RO)

A representative office can be set up by a foreign company to render preparatory services such as liaison, coordination and market research on behalf of its parent company. It is important that a representative office cannot engage in any direct profit-making activities.

According to latest regulations promulgated by The State Council of the PRC on 11 November 2010, a RO is allowed to have maximum 3 representatives and the term of RO's operation cannot exceed 1 year that is allowed to apply for extension for another 1 year on yearly basis.

Other Forms of Entities in China

The other forms of entities in China including individual-owned business, partnership, company limited by shares

and public limited company, however, non of them is opened for foreign investors currently.



Commercial and Residential Property

Freehold

No freehold property in China.

Leasehold

The term of leasehold is limited at 70 years.

Ownership

Investors who want to buy commercial & residential property need to observe the Chinese rule of property investment. Foreign individuals can buy commercial or residential real estate in China in individual capacity,

whereas foreign companies can buy commercial or residential real estate in China only through a Wholly Foreign-Owned Enterprise (WFOE) or Joint Venture (JV) established in China.

Mortgages

To obtain the property mortgages in China, the applicants must have valid identity proof; be capable of repaying loans and due interest in time; stable income; signed housing sales contract or pre-sales contract; assets accepted by the bank as mortgage or collateral; or have secured joint-liability guarantee from a third party with sufficient capacity of repaying principal and due interest for applicant.

For the property purchased, it should be structurally fit, land fee fully paid, all compliance formalities secured, quality-check passed and satisfied all conditions as required by related authorities for issuance of house property certificate or having already secured property certificate.

Mechanics of Property Acquisition

Buying real estate in China is regulated by strict laws. If you buy through a property agent from overseas, your agent will negotiate on your behalf with the vendor. Once a price has been agreed on, a Customer Confirmation Agreement is signed by all parties and the deposit is held by the agent until all conditions have been met by the parties.

Thereafter, a visit to the Realty Transaction Department will begin the official transfer process. A Property Purchasing Registration Form and a Property Selling Registration Form will have to be completed and filed with the Property Ownership Certificate. Once this has

been fulfilled, the Realty Transaction Department will give the vendor and investor a date for the official Realty Transfer Notice to be given.

At agreed date, all parties or their representatives (lawyers, notaries) meet at the Realty Transaction Department for the finalization of the transaction.

Buying from developers will still need to go through similar procedures. The process might vary from city to city and you are advised to seek legal advice before you sign anything with respects to property acquisition.

Survey

Some property agents may have property markets survey done. Therefore, one needs to ask for it from such agents.

Taxation of property

The owner of property shall be liable for the payment of Real Estate Tax (RET). The RET is calculated based on one of the following methods:

- 1.2% per annum on the residual value of the property for tax purpose; or
- 12% per annum on rental income of real estate.



Employment in China

Key Features

Newspapers, on-line recruitment and recruitment agency are the common recruitment mediums in China. All employees are required to sign employ contract with the company as required by PRC Labor Contract Law, effective from 1 January 2008. All companies in

China are responsible to pay social insurance for local employees. Normally, the social insurance includes work injury, maternity, pension, unemployment and housing fund, etc. The rate of social insurance in Shanghai is set out as below:

Monthly payment for Shanghai permanent resident (under Hukou system [a local residence registration system] staff or staff who possess resident permit or temporary resident permit where the company join normal urban Social Insurance scheme (determined by the location of the registered address of the company)

Social Insurance 48%								Housing Fund 14%	
Employer - 37%					Employee - 11%			Employer	Employee
Work Injuring	Give Birth	Pension	Medical	Unemployment	Pension	Medical	Unemployment		
0.5%	0.5%	22%	12%	2%	8%	2%	1%	7%	7%

Monthly payment for Shanghai permanent resident (under Hukou system [a local residence registration system] staff or staff who possess resident permit or temporary resident permit where the company joins sub-urban social insurance scheme (determined by the location of the registered address of the company)

Social Insurance 25%					Housing Fund 14%	
Employer - 25%					Employer	Employee
Work Injuring	Give Birth	Pension	Medical	Unemployment		
0.5%	0.5%	17%	5%	2%	7%	7%

Doing Business in China

Monthly payment for staff who possess temporary resident and choose not to join the above schemes but joins the Comprehensive Social Insurance scheme

Comprehensive Social Insurance 12.5%			Housing Fund 14%	
Employer			Employer	Employee
Work Injuring 0.5%	Pension 0.5%	Medical 17%	7%	7%
12.5%				

The rate of social insurance will be changed on annual basis. The base salary to be used for calculation of the above social insurance is based on the salary payable to the staff but with a minimum base of RMB 2,140 and a capped base of RMB 10,698 for year 2010 (Shanghai). The statutory minimum and maximum salary base for social insurance calculation will vary from city to city and changes in April of every year.

Employees are required to pay Individual Income Tax ("IIT") on the amount of salary on a monthly basis. Employer is required to withhold and pay the IIT to the relevant tax bureaus for its staff. Effective from March 1, 2008, a monthly deduction of RMB 2,000 (RMB 4,800 for foreign employees) is allowed in calculating the IIT liabilities. IIT is levied at the progressive rates from 5% to 45%. The rates of IIT on salaries and wages are as follows:

	Monthly Taxable Income (RMB) *	Tax Rate (%)	Quick Reckoning Deduction
1	0 – 500	5	0
2	501 – 2,000	10	25
3	2,001 – 5,000	15	125
4	5,001 – 20,000	20	375
5	20,001 – 40,000	25	1,375
6	40,001 – 60,000	30	3,375
7	60,001 – 80,000	35	6,375
8	80,001 – 100,000	40	10,375
9	100,001 onwards	45	15,375

* Monthly taxable income = Monthly salary and wage income – 2,000 or 4,800