Setting up a company

Company incorporation in China is complicated and requires considerable effort in terms of planning and analysis.

BEFORE STARTING UP a business in China, investors should be able to answer a number of important questions about the registration process and the regulations that relate specifically to their business.

- Is my company eligible to invest in China?
- What types of business presence are available?

Is my company eligible to invest?

Industries are categorised for foreign direct investment (FDI) as:

"Permitted"— any industry not listed in the Foreign Investment Catalogue is a "permitted" industry;

"Encouraged"— sectors that promote the development of agriculture, involve high technology, upgrade product quality, promote environmental protection, promote exports, and that will help in the development of the poorer and less-developed interior regions;

"Restricted"— those industries that are technologically backward, environmentally unfriendly or that are being opened up to foreign investment on a pilot basis;

"Prohibited"—those industries that use technology unique to China or which harm the national interest, are damaging to the environment or human health, jeopardise security or are politically sensitive.

What type of business presence?

Foreign investors generally establish a business presence in China in one of six ways: wholly foreign-owned enterprise (WFOE); foreign-invested commercial enterprise (FICE); representative office (RO); joint venture (JV); partnership enterprise (PE); or Hong Kong company.

Wholly foreign-owned enterprise

The WFOE is a limited liability company wholly owned by the foreign investor(s). In China, WFOEs were originally conceived for encouraged manufacturing activities that were either export orientated or which introduced advanced technology.

Advantages The advantages of establishing a

Business compliance Setting up-Foreign Investment Catalog

Status of industry/activity	Description	Example
Encouraged	● Special incentives possible ● Usually high-tech or agriculture industries	● Manufacture of high-performance welding robots ● Operation of nurseries
Permitted	● All activities not mentioned in catalogue are permitted ● But may be difficult to get approval for uncommon activities	● All sectors not mentioned in catalog
Restricted	● Special approval required usually JV partner necessary ● Usually are protected sectors	● Production of cigarettes ● Operation of oil refineries
Prohibited	● Activities are disallowed ● Harms national interests or environmentally damaging	● Arms manufacturing ● Operation of gaming industry

WFOE include, but are not limited to:

- independence and freedom to implement the worldwide strategies of its parent company without having to consider the involvement of the Chinese partner;
- ability to formally carry out business rather than just function as a representative office and being able to issue invoices to customers in Rmb and receive revenues in Rmb;
- capability to convert Rmb profits to US dollars for remittance to its parent company outside China;
- protection of intellectual know-how and technology.

Business scope Business scope needs to be defined and the WFOE can only conduct business within its approved business scope, which ultimately appears on the business licence. Any amendments to the business scope require further application and approval.

Registered capital Registered capital is the amount that is required to run the business until it can break even – the 'minimum registered capital' is a guideline only. However the amount of registered capital needed is also dependent upon factors such as the scope of business and location. In reality, local authorities will review the feasibility study report (and check the lease contract) and approve the investment on a case-by-case basis; reduced registered capital can be negotiated in some cases.

Social security in China A new rule on foreign employees' social security started on 15 October 2011. It states that, if a company hires a foreign employee, it shall register this employee with the local social security authority within 30 days of the employee receiving their work permit.

General tax Information Since January 2008, China's corporate tax rates have ranged from15% to 25%, with the rate depending on the places where the company is registered and the industry in which it is engaged. All enterprises are required to report to the Tax Administration Department monthly, quarterly and annually.

Annual audit report and licences renewal Any limited companies in China should summit annual audit report to the relevant authorities and make the licences renewal. Any company will be subject be to a fine if the annual audit report is not submitted in a timely manner.

Profit repatriation The Chinese government allows foreign-invested enterprises to remit their profits out of the country and such remittances do not require the prior approval of the State Administration of Foreign Exchange (SAFE). Dividends cannot be distributed and repatriated overseas if the losses of previous years have not been covered, while dividends not distributed in previous years may be distributed together with those of the current year. Repatriating the reregistered capital to home countries is forbidden during the term of business operation.

Terms and termination In China, terms of 15 to 30 years are typical for a manufacturing WFOE (although some may have a longer term). It is also possible to obtain extensions to the WFOE's duration.

Foreign-invested commercial enterprise

On 16 April 2004, the new Measures for Foreign Investment in Commerce were promulgated by China's Ministry of Commerce (MOFCOM). According to the measures, foreign-invested commercial enterprises (FICEs) can distribute imported and locally manufactured products through their own wholesale, retail and franchise systems and provide a host of related services, including storage, warehousing and garage services, inventory management, repairs, maintenance, training and delivery.

A FICE is defined as a foreign-invested enterprise that engages in the following areas:

- agency with commission: selling other owned goods and providing related services by sales agency of goods, broker, or auctioneer or other wholesaler on the basis of contractual relationship;
- wholesale business: selling goods and providing related services to retailers, industrial users, commercial users, organisational users and other wholesalers;
- retail business: selling goods and providing related services to individual or collective consumers in fixed locations or by means of television, telephone, internet and automat;
- franchise business: licensing of trademark, trade name and business mode by entering into a contract with others for the purpose of returns and licence fee.

The business scope of a FICE includes the

Actually utilised value of foreign direct investment (2010)

Item	Actually utilised value (USD100 million)
Equity joint venture	1,057.35
FDI shareholding Inc.	809.75
Contractural joint venture	224.98
Wholly foreign-owned enterprise	16.16
Joint exploration	6.46

Source: China Statistical Yearbook 2011

retail or import of self-operation goods and the purchase and export of domestic goods and related services. Wholesaling and agency operations with commission are also permitted. The other main points relating to a FICE are the same as with a WFOE.

Representative office

A representative office (RO) is established by foreign companies to engage in business liaisons, quality control, product promotion, market research, exchange of technology and other permitted activities in China. It can only engage in non-profit making activities, and can carry out the following functions:

- conduct research and surveys for its parent enterprise in the local market;
- liaise with local and foreign contacts in China on behalf of the parent enterprise;
- conduct research and provide data and promotional materials to potential clients or trading partners;
- act as a coordinator for the parent enterprise's activities in China;
- make travel arrangements for parent enterprise representatives and potential Chinese clients;

The representative office is a non-legal entity that represents its parent company overseas. Its name should be in the form of "Name of the Enterprise + Name of the City + Representative Office". The business address must be located in commercial buildings or apartments that have been approved by the government. It also needs to register employees with the local social security authority within 30 days of the employee receiving their work permit.

Joint venture

A joint venture is a business arrangement in which the participants create a new business entity or official contractual relationship and share investment and operation expenses, management responsibilities, and profits and losses. There are two types of joint venture:

Equity joint venture EJVs are the second most common entity in which foreign companies enter the China market and the preferred manner for cooperation where the Chinese government and Chinese businesses are concerned. There are specific requirements for the management structure of a joint venture but either party can hold the position as chairman of the board of directors. A minimum of 25% of the capital must be contributed by the foreign partner(s). There is no minimum investment for the Chinese partner(s).

Equity can include cash, buildings, equipment, materials, intellectual property rights and land-use rights but cannot include labour. The value of any equipment, materials, intellectual property rights or land-use rights must be approved by government authorities before the joint venture can be approved.

Co-operative joint venture In a Sino-foreign co-operative venture (also known as a contractual joint venture or CJV), the parties involved may operate as separate legal entities and bear liabilities independently rather than as a single entity. A co-operative venture may also be registered as a limited liability entity resembling an equity joint venture in operation, structure, and status as a Chinese legal entity.

For an EJV:

- each party must make cash or permitted contributions in proportion to its subscribed percentage of the EJV's registered capital;
- profit must be distributed strictly in accordance with the parties' respective percentage shareholding of the registered capital of the EJV;
- and upon dissolution of the EJV at the expiry of the term of operation, the EJV's net assets are to be distributed to each party in accordance with its respective shareholding of the EJV's registered capital.

For a CJV:

- a party (typically, but not always, the Chinese party) may contribute non-cash intangibles in the form of "cooperative conditions";

- profit sharing need not be made strictly in accordance with the parties' respective percentage shareholding of the registered capital of the CJV but can be made in accordance with the agreement of the parties;
- upon dissolution of the CJV at the expiry of the term of operation, the CJV's net assets may be transferred to the Chinese party without compensation (thus operating in many respects as a BOT project), so long as the foreign party has been able to recoup its capital contribution during the term of the CJV.

The capital to be injected by the parties constituting their capital contribution may take a variety of forms, including cash, machinery, equipment and intangible property, such as proprietary technology, trademarks and other industrial property rights. Chinese law permits joint ventures to borrow funds from either Chinese or foreign banks in excess of the parties' capital contributions. Shareholder loans from the foreign party are also permitted.

If a party proposes to transfer all or part of its interest in the registered capital of the joint venture company to a third party, then each other party has a pre-emptive right to purchase the equity interest proposed to be transferred. As equity transfer also requires amendment of the joint venture contract and articles of association, which in turns requires the signature of each party, each party in effect holds absolute consent rights to any transfer generally. All transfers of registered capital additionally require a unanimous approval of the joint venture company board of directors and approval by the original government authority that approved the joint venture contract and articles of association.

Partnership enterprise

Since 1 March 2010, the Measures of Establishment of Foreign Enterprises or Individuals Partnership Enterprises (FIPE) in China has been in effect. There is no required minimum registered capital for a partnership enterprise (PE) in China.

There are three main types of types of FIPE.

General partnership enterprise A general partnership enterprise may be formed by general partners who bear unlimited joint and several liabilities for the debts of the partnership. The general partners share unlimited liabilities for the debt of the partnership.

Limited partnership enterprise A limited partnership enterprise is formed by a combination of general partners and limited partners where the limited partners bear the liabilities for the partnership's debts to the extent of their capital contributions.

Special general partnership enterprise This enterprise resembles a general partnership except that it must be a professional service institution offering services requiring professional knowledge and special skills. The structure shields co-partners from liabilities due to the wilful misconduct or gross negligence of one partner or a group of partners. It is very similar to limited liability partnership in Europe and the US.

The advantages of establishing a PE, compared with other types of enterprise, include, but are not limited to:

- no corporate income tax for partnership enterprise, the partners shall pay their respective share of the partnership income;
- no requirements on minimum registered capital;
- capability of converting Rmb profits to US dollars for remittance to its parent company outside China;
- foreign enterprise or individual is allowed to establish a PE with a Chinese individual;
- the profit distribution of a PE could follow an informal negotiated agreement or abide by scheme adopted in the partnership agreement.

The disadvantages of a PE include:

- unlimited liability – a partnership must pay all its debts with property contributed to the partnership by the partners. If the partnership is a general partnership, then the partners bear joint and several liability;
- not allowed to use "Company" in a business name – alternatives such as Firm or Centre must be used instead;
- property rights are difficult to be transferred to a third party;
- China has not adopted Natural Person's Bankruptcy system, and credibility of the partners would be hard to maintain if PE finds itself in a difficult situation;
- since PE is not a general tax payer, it cannot

National associations of China

Name of association	Principal	Website
All-China Journalists Association	Congming Tian	www.zgjx.cn
China Alcoholic Drinks Industry Association	Yangcai Wang	www.cada.cc
China Arts & Crafts Association	Zhengsheng Zhou	www.cnaca.net.cn
China Association for Exhibition Centers	Shijun Zheng	www.caec.org.cn
China Association For Quality	Bangzhu Chen	www.caq.org.cn
China Association For Science and Technology	Qide Han	www.cast.org.cn
China Association of Agricultural Machinery Manufacturers	Yuan'en Gao	www.caamm.org.cn
China Association of Automobile Manufacturers	Maoyuan Hu	www.caam.org.cn
China Association of Bakery & Confectionery Industry	Nianlin Zhu	www.china-bakery.com.cn
China Association of Fragrance Flavor and Cosmetic Industries	Tiecheng Zhang	www.caffci.org
China Association of Lighting Industry	Yansheng Chen	www.chineselighting.org
China Association of National Shipbuilding Industry	Guangqin Zhang	www.cansi.org.cn
China Banking Association	Jianqing Jiang	www.china-cba.net
China Battery Industry Association	Shanmei Zhang	www.chinabattery.org
China Bearing Industry Association	Enshi Liu	www.cbia.com.cn
China Beverage Industry Association	Yali Zhao	www.chinabeverage.org
China Brick & Tile Industry Association	Xiangyuan Sun	www.cbtia.com
China Building Materials Industry Association	Renwei Zhang	www.cbminfo.com
China Cement Association	Qianzhi Lei	www.cncement.com.cn
China Ceramic Industry Association	Tianxiong He	www.ccianet.cn
China Chemical Fibers Association	Zhiyi Zheng	www.ccfa.com.cn
China Chlor-Alkali Industry Association	Jun Li	www.ccaia.org.cn
China Commerce Association for General Merchandise	Xiuqi Chu	www.ccagm.org.cn
China Construction Machinery Association	Jun Qi	www.cncma.org
China Construction Units Association	Yongmuo Xu	www.chinacb.cn
China Crop Protection Industry Association	Haizhang Luo	www.ccpia.org.cn
China Cuisine Association	Qiucheng Su	www.ccas.com.cn
China Dairy Industry Association	Kungang Song	www.cdia.org.cn
China Die & Mould Industry Association	Kexin Chu	www.cdmia.com.cn
China Dyestuff Industry Association	Zhuo Wang	www.dyechina.com
China Electrical Equipment Industry Association	Lei Geng	www.ceeia.com
China Electronics Standardization Association	Hongkun Liu	www.cesa.cn
China Feather & Down Industry Association	Rusheng Wang	www.cfd.com.cn
China Feed Industry Association	Meiqing Bai	www.chinafeed.org.cn
China Fermentation Industry Association	Weichen Shi	www.cfia.org.cn
China Futures Association	Zhichao Liu	www.cfachina.org
China General Chamber of Commerce	Zhigang Zhang	www.cgcc.org.cn
China General Machinery Industry Association	Yongbin Sui	www.cgmia.org.cn
China Glass Industry Association	Renwei Zhang	www.glass.org.cn
China Gold Association	Zhaoxue Sun	www.cngold.org.cn
China Horologe Association	Yumin Tian	www.chinawatch-clock.com
China Hotel Association	Ming Han	www.chinahotel.org.cn

Name of association	Principal	Website
China Household Electrical Appliances Association	Feng Jiang	www.cheaa.org
China Humic Acid Industry Association	Xiancheng Zeng	www.chinaha.org
China Industrial Design Association	Tao Zhu	www.chinadesign.org.cn
China Industrial Gases Industry Association	Jun Du	www.china-gases.com
China Industry Cooperative Economic Society	Zongyin Gao	www.chinagungho.org
China Inorganic Salts Industry Association	Haiting Ye	www.cisia.org
China Internal Combustion Engine Industry Association	Xuguang Tan	www.ciceia.org.cn
China Iron & Steel Association	Qilin Deng	www.chinaisa.org.cn
China Knitting Industry Association	Shibin Yang	www.eck.com.cn
China Leather Industry Association	Shuhua Zhang	www.china-leather.com
China Logistics Technology Association	Weizhong Mu	www.clta.org.cn
China Machinery Industry Federation	Ruixiang Wang	www.mei.gov.cn
China Musical Instrument Association	Zhi An	www.cmia.com.cn
China National Coal Association	Xianzheng Wang	www.coalchina.org.cn
China National Coatings Industry Association	Lianying Sun	www.chinacoatingnet.com
China National Food Industry Association	Wenzhe Wang	www.cfia.cfiin.com
China National Forest Product Industry Association	Zhibang Jia	www.chinalycy.org
China National Furniture Association	Qingwen Jia	www.cnfa.com.cn
China National Hardware Association	Dongli Zhang	www.chinahardware.org.cn
China National Interior Decoration Association	Limin Fu	www.cida.gov.cn
China National Light Industry Council	Zhengfa Bu	www.clii.com.cn
China National Textile & Apparel Council	Yuzhou Du	www.ctei.gov.cn
China Non-Metallic Minerals Industry Association	Zhan Zhang	www.cnmia.cn
China Oral Care Products Industry Association	Taijun Han	www.cocia.org.cn
China Paper Chemicals Industry Association	Xianping Yao	www.paperchemicals.org
China Petroleum and Chemical Industry Association	Yongwu Li	www.cpcia.org.cn
China Plastic Machine Industry Association	Jingzhang Zhang	www.cpmia.org.cn
China Plastics Processing Industry Association	Zhengpin Liao	www.cppia.com.cn
China Polyurethane Industry Association	Zhiqiang Li	www.pu.org.cn
China Refrigeration & Air-Conditioning Industry Association	Gaoding Fan	www.chinacraa.org
China Rubber Industry Association	Rende Fan	www.cria.org.cn
China Sewing Machinery Association	Minyu Tian	www.csma.org.cn
China Soda Industry Association	Tongli Di	www.chinasoda.com.cn
China Stationery & Sporting Goods Association	Li Yang	www.csg.org.cn
China Stone Material Industry Association	Chuansheng Zou	www.chinastone.cn/csmia
China Toy Association	Xiaoguang Shi	www.toy-cta.org
China Traveling Hotels Association	Rungang Zhang	www.ctha.org.cn
China Weighing Industry Association	Jingyao Zhang	www.weighment.com
China Writing Instrument Association	Juncheng Gao	www.china-writing.com.cn
Insurance Association Of China	Jianqiang Jin	www.iachina.cn
Printing & Printing Equipment Industry Association of China	Zhen Yu	www.chinaprint.org.cn
Securities Association of China	Xiangping Huang	www.sac.net.cn

get VAT status, nor apply for VAT rebate accordingly.

A partner may contribute capital to the partnership to garner a share of the partnership's profits or losses. A capital contribution may include money, intellectual property right, land use right or other properties or labour services at a valuation determined by agreement among the partners. If the partnership is a limited partnership, then the limited partners may not make capital contributions with labour services.

The default distribution scheme of profits or losses follows the proportion to capital contributions made by the partners. However, the distribution scheme may follow an informal negotiated agreement or abide by a scheme adopted in the partnership agreement. If the proportions of capital contributions cannot be discerned, then the profits or losses will be distributed equally by the partners. The partnership agreement may not distribute all losses or all profits to just one or a group of partners within the partnership.

The Chinese government allows foreign-invested partner enterprises to remit their profits out of the country without the prior approval of the State Administration of Foreign Exchange (SAFE). Dividends cannot be distributed and repatriated overseas if the losses of previous years have not been covered, while dividends not distributed in previous years may be distributed together with those of the current year. Repatriating the registered capital to home countries is forbidden during the term of business operation.

In China, terms of 15 to 30 years are typical for a PE. It is also possible to obtain extensions of the PE's duration.

In common with other types of enterprise, when a PE hires a foreign employee, it shall register this employee with the local social security authority within 30 days of the employee receiving their work permit.

Hong Kong company

Hong Kong continues to play a role as a major trading and investment gateway to mainland China and other parts of Asia. Some companies are established in Hong Kong for trading purposes, while others use it as the headquarters for their operations in mainland China. Hong Kong places no restrictions on capital transfer into or out of the SAR.

The benefits of setting up a Hong Kong company include:

- free to choose the name of the company;
- little restriction in terms of business area;
- only two kinds of taxation: one is the stamp tax of the registered capital, which is decided by the actual registered capital and its rate is 0.001; the other is income tax, which is decided by the actual profit, and is set at 16.5%;
- modicum registered capital and no need of inspection;
- easy to get international credit.

As many foreign companies continue to source from China via Hong Kong, it is worthwhile taking a closer look as to why this model enjoys ongoing popularity and how to implement an efficient set-up. There are many good reasons for companies to manage their supply chain from Hong Kong, including:

- a good infrastructure, a legal framework based on British law, a transparent and efficient banking system, fair taxation, a fully convertible currency and a qualified workforce;
- no storage costs and less financial risk;
- lower tax rates through HK company operation offshore with its WFOE in China;
- relaxed constraints on restructuring operations.

As a matter of fact, a full blown model for offshore structures would recommend an offshore investment vehicle on the back of each investment into mainland China. The pros and cons of such a complete model as opposed to a single buffer holding company must be evaluated on a single client base.

Conclusion

Company incorporation in China is complicated and requires great effort in terms of planning, investigation and analysing. An effective and speedy application requires co-ordination between the applicant and its China advisors.

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