

Company Set-up in China

Compiled by

Swiss Business Hub China

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Swiss and other foreign companies may enter into the Chinese market through legal entities or non-legal entities. Legal entities that can be set up by foreign investors, so called Foreign Invested Enterprises (FIE) generally include wholly foreign-owned enterprises (WFOEs), equity joint ventures (EJVs), co-operative joint ventures (CJVs) and joint stock companies. Non-legal entities include representative offices (ROs) and branches.

Let's take a closer look at the three most prevalent company forms of foreign enterprises in China:

1. WFOEs

Wholly Foreign Owned Enterprise. A WFOE in its structure is organized as a limited liability company and in general is a desirable investment vehicle for foreign investors assuming the investment regulations do not require the participation of a Chinese partner. The limited liability company offers foreign investors sole control of the business operation and avoids disputes with Chinese partner, as in the case of joint ventures. Furthermore WFOEs are able to conduct business transactions in China and also allowed to hire local personnel in their name, rights which Representative offices are not awarded.

There is no legal minimum or maximum capital contribution requirement for a foreign company to establish a WFOE. Capital may be contributed as hard currency or tangible assets or (with approval) renminbi. Valuation must be consistent with international principles. Under the Company Law, in theory industrial property and technology may not exceed 70% of the registered capital of the enterprise. When capital is contributed in installments, the first installment must be not less than 20% of the total contributed capital and must be delivered within 90 days from the date the business license is issued. The deadline for completing the contribution is two years from the date the business license is issued.

There is no mandatory management structure for a WFOE, but the articles of association must set out a structure in detail (including the duties and limits of authority of the legal representative, chief accountant, general manager and chief engineer). The articles of association must specify procedures for termination and liquidation and for amending the articles.

Stage 1: Preliminary approval - Project Proposal

The application procedure for setting up a WFOE is simpler. The project proposal will be prepared by the foreign investors and submitted directly to local authorities. The foreign investor may appoint a local agent to liaise with the government. To do so, he has to sign an authorization letter stipulating the agent's scope of services, responsibility and fees.

Generally, the authority will give an official reply within 30 days upon receipt of the proposal and other relevant documents. The approval or rejection letter will be issued to the foreign investor. If a favourable reply is received, the foreign investor can proceed to register the company's name at the local Administration for Industry and Commerce (AIC).

The report must contain information regarding the objectives of the WFOE, business scope, scale of operation, products to be produced, technology and equipment to be used, land area required, conditions and quantities of water, electricity, gas and other forms of energy resources required, and requirements for public facilities. The structure and the rights of the WFOE will depend on the nature of its business. Categories of enterprises include Service, manufacturing, international trading commercial enterprise, R & D Center, Investment Holding, etc. Depending on the category different rights are associated, such as import/export license, manufacturing license, retail/wholesale license, etc.

Stage 2: Formal approval - Articles of Association

After the foreign investor receives a written reply from the relevant government authorities, a formal application supported by all the required documents should be filed with the local Ministry of Commerce at a county, municipal or provincial level. After receiving the formal approval, the foreign investor should apply to the Ministry of Commerce again for an approval certificate by presenting all the necessary documents.

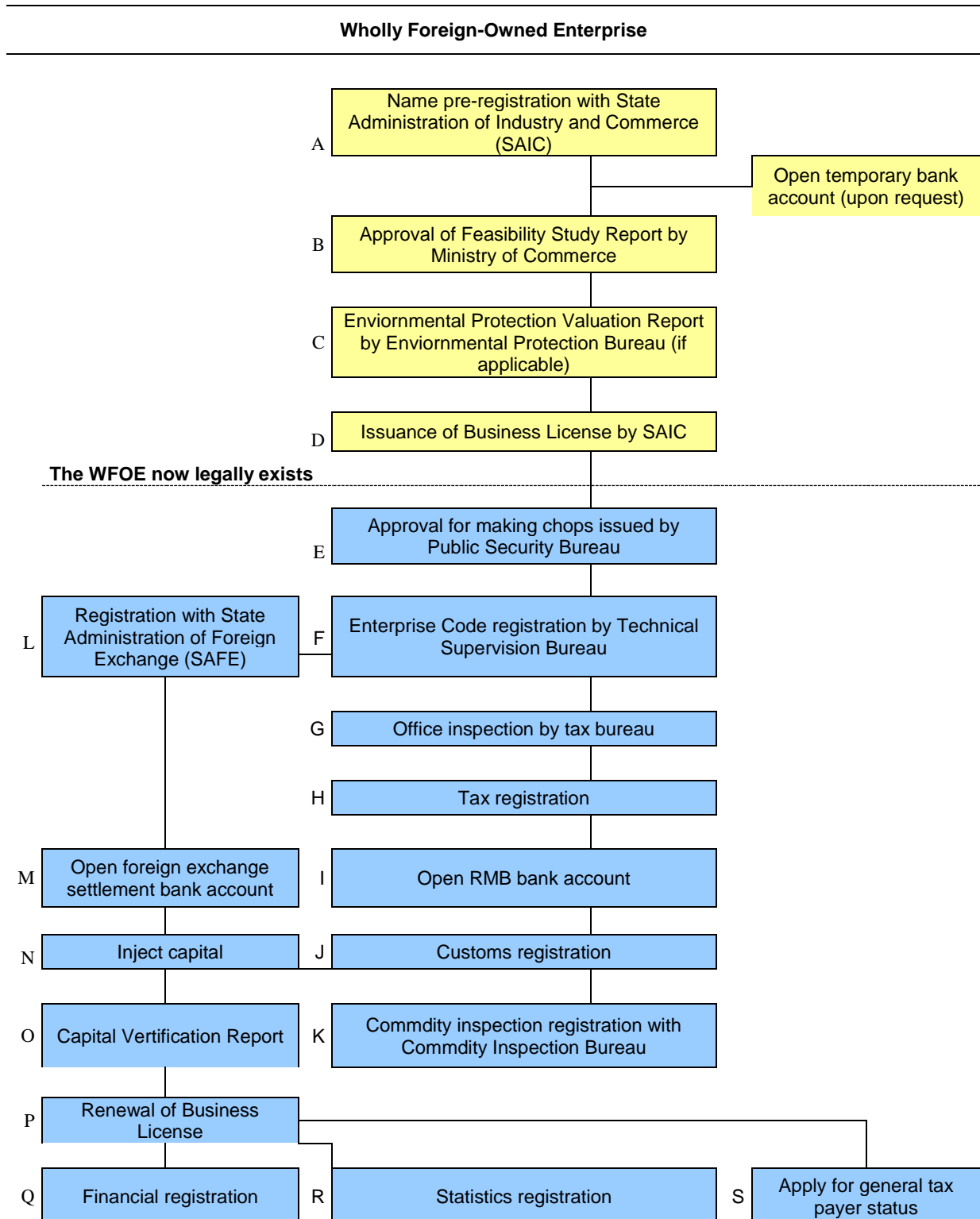
The required documents include the application letter for establishing the WFOE; a feasibility study report (if any), articles of association, list of legal representatives (or Board of Directors), the foreign investor's legal papers and credit report, a list of materials to be imported, written replies from the local approval authorities at county level or above, application for registration of the name of the enterprise approved by the provincial or municipal administration AIC, comments on the project by various government departments such as environmental protection, fire services, health and land administration. In the case where two or more foreign investors are involved, copies of the contracts signed by them should be submitted to the approval authority for their records.

Stage 3: Business License

Upon collection of the approval certificate, an application for a business license has to be filed with the provincial or municipal AIC within 30 days. The local AIC will issue the business license within 10 working days to projects that have passed the examination. Likewise, the date the business license is issued will be considered the official date of the establishment of the enterprise.

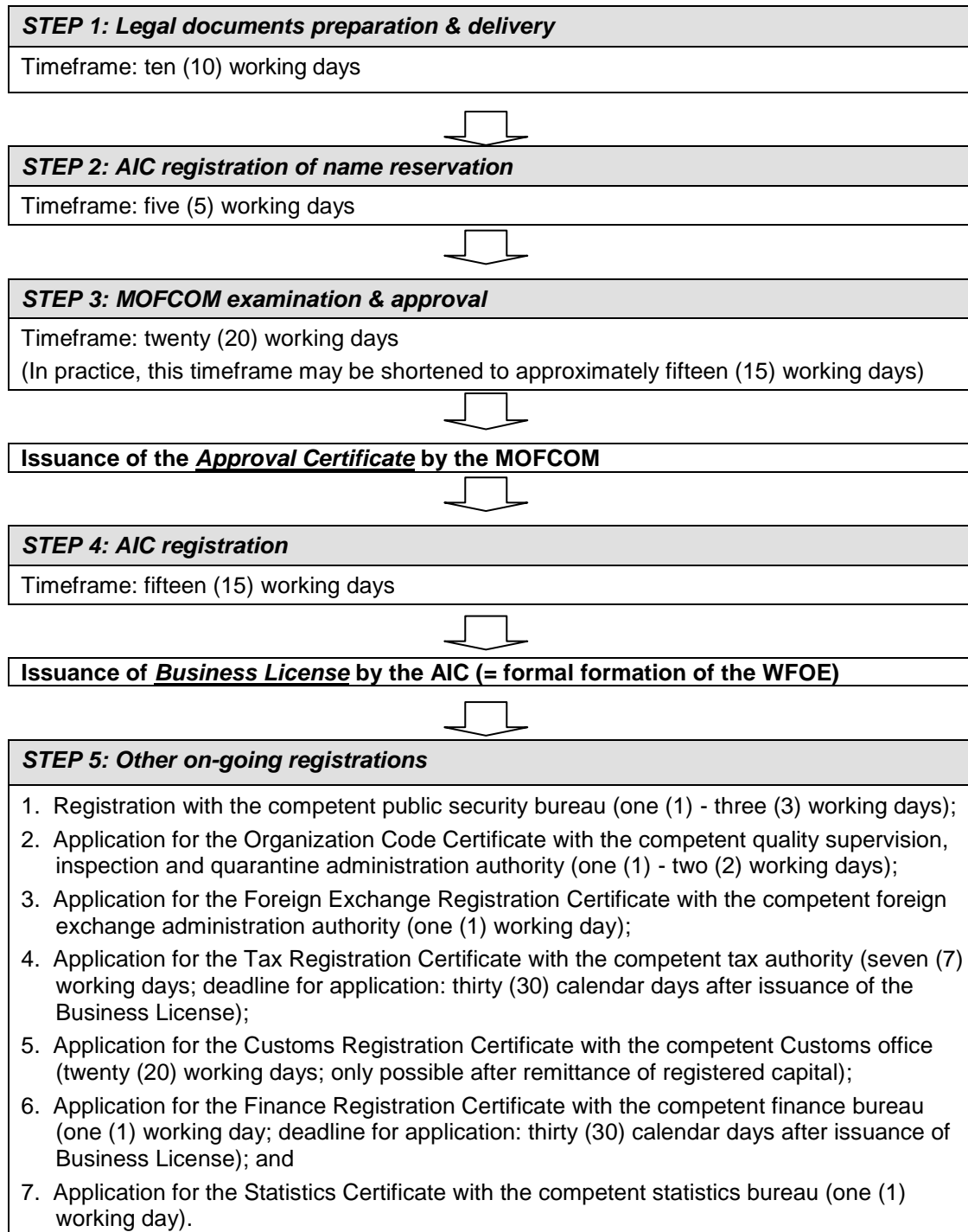
Having acquired the business license, the WFOE has to finish up with procedures such as applying for an official seal and enterprise code, opening a bank account, and registering for tax payment and customs declaration with the local public security, technical supervision, taxation, customs, finance, foreign exchange administration, banking, insurance and commodity inspection departments.

WFOE Registration Procedure



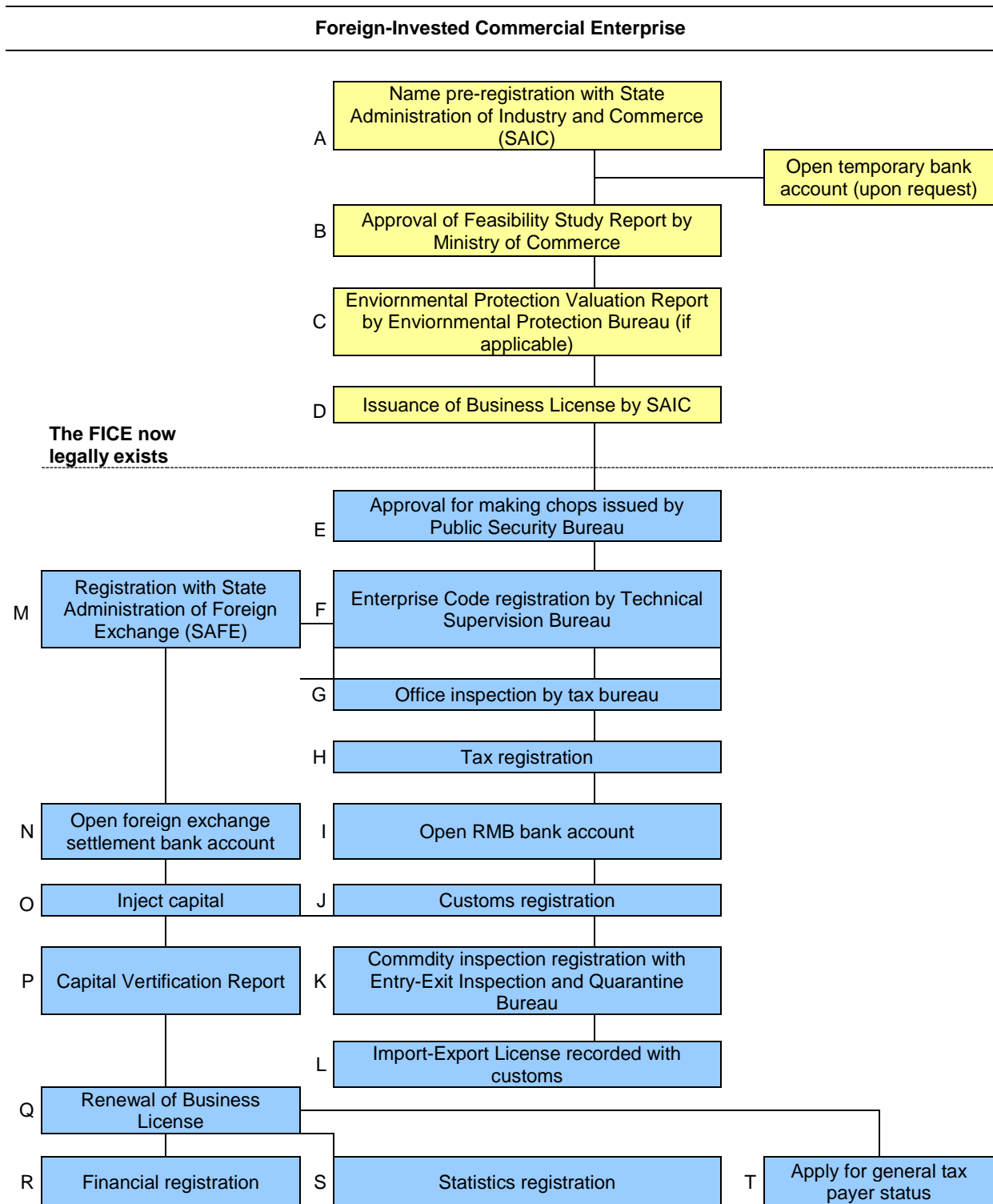
*Procedural Timeframe: Typically three to four months from commencement to license issuance - depending on specific licensing complexities within certain industries.

WFOE Establishment Procedure and Time Frame



Note: The timeframes above shall be counted from the time point when a complete set of application documents required by law is accepted by the competent government authorities.

Foreign Invested Commercial Enterprise (FICE) Setup Procedure



*Procedural time frame: with proper consideration and planning, the process typically takes three to four months depending on specific complexities from commencement to license issuance.

2. Representative Offices

A representative office may only engage in non-profit making activities. It acts as a liaison office for the parent company. Accordingly, it may engage in any of the following functions: conducting research and providing data and promotion materials to potential clients and partners, conducting research and surveying for its parent company in the local market, liaising with local and foreign contacts in China on behalf of its parent company, acting as a coordinator for the parent company's activities in China, making travel arrangements for parent company representatives and potential Chinese clients and other non-profit making business activities. Albeit representative offices are from a set-up point of view the easiest to establish and give companies with little China experience an official legal presence in the country, in recent years ROs have been losing importance, mainly because of their 2 main drawbacks: not being able to conduct business transactions and having to hire local personnel through a government employment agency (FESCO).

Representative offices. Foreign companies, particularly those in the services industries, continue to rely on representative offices (ROs) to conduct business. Although ROs allow foreign investors to enter the Chinese market with little initial investment, they are prohibited from direct profit-making activities. In general, an RO of a foreign company may only engage in non-operational business activities in China, including the following:

- Liaison with clients of the head office;
- Introducing the products of the head office;
- Market research;
- Collection of information.
- Liaison activities in relation to the product sales, service provision, domestic sourcing and investment of the foreign enterprise.

Thus an RO of a foreign company may not sign and conclude contracts with Chinese customers directly and is prohibited from engaging in any "direct business operations" (with certain exceptions, such as the representative office of a law firm). Foreign companies must apply to the ministry at the local or national level, depending on the business, to set up an RO.

Foreign financial institutions must follow separate rules to establish ROs. Special rules also apply for ROs in the Shenzhen SEZ, Guangdong province and the Shanghai municipality. Despite differences in the details of these provisions and those of the national registration regulations, the basic registration procedure remains the same: (1) formal approval to establish the office must be obtained; and (2) formalities must be completed with the SAIC to obtain a registration certificate.

The central bank is responsible for granting registration certificates to ROs established by foreign banks and insurers.

Stage 1: Appoint an Agent

The applicant appoints an agent, which must be a Foreign Enterprises Service Company or "FESCO" in Mainland China. The local agent must be authorized by Ministry of Commerce of the PRC to handle representative office applications.

Stage 2: Submission of Applications

On behalf of the applicant, the Chinese agent will submit all the required documents to the provincial Ministry of Commerce for the handling of application procedures.

The relevant documents include the application letter signed by the Chairman of the Board or General Manager; incorporation documents of the company, the previous year's financial statement; an original bank reference letter attesting to the company's financial status, a letter of appointment of the chief representative signed by the Chairman of Board or the General Manager with the company's stamp and the chief representative's resume, copies of his or her identification, passport and photos, and a copy of the leasing agreement for the representative office and other documents that are requested by the authorities.

Stage 3: Business Certificate

After obtaining an approval permit from the provincial or municipal Ministry of Commerce, the foreign investor should proceed promptly to the provincial or municipal AIC for registration and acquire a business certificate.

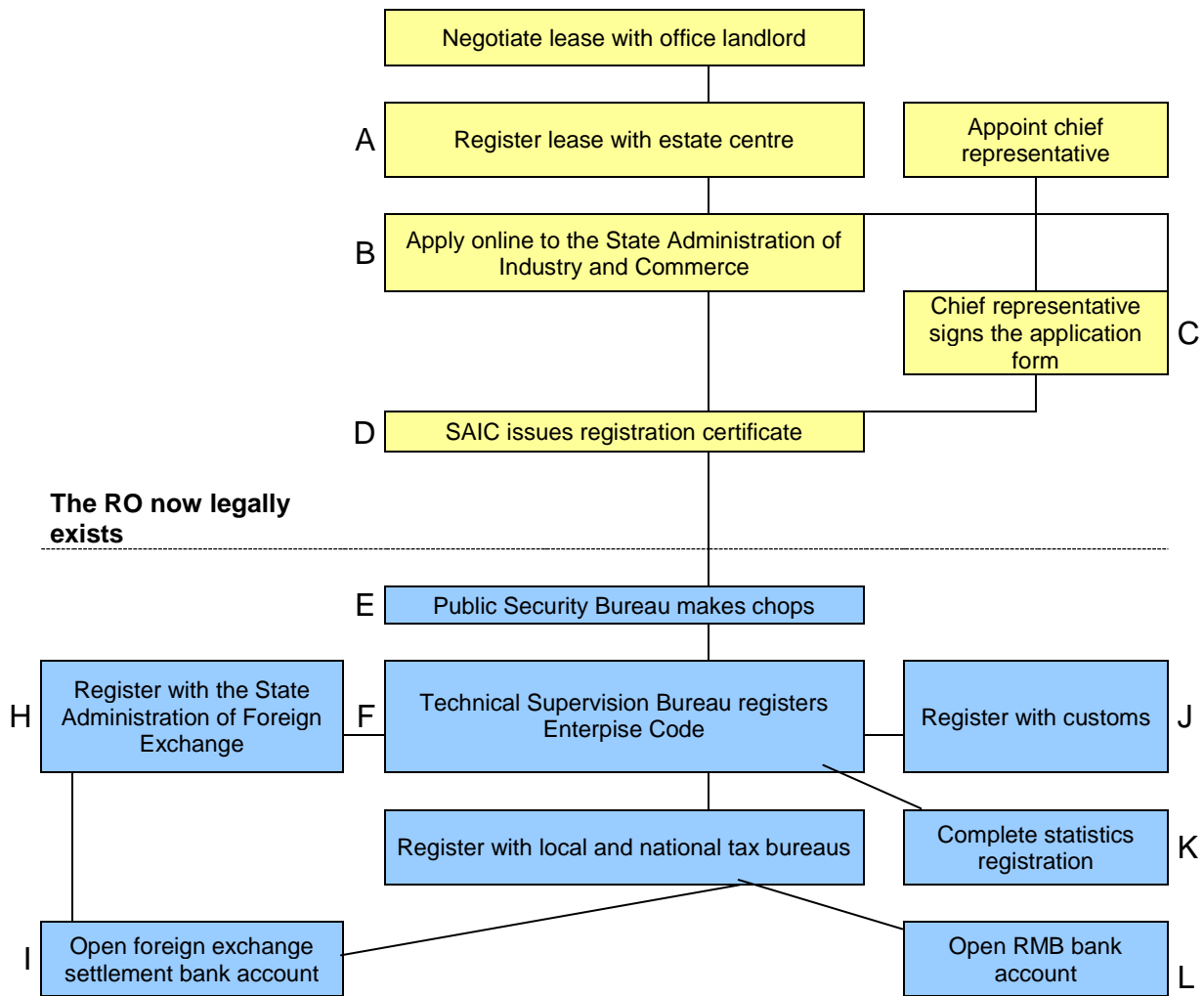
Stage 4: Post-registration formalities

Other formalities to be handled by the resident representative:

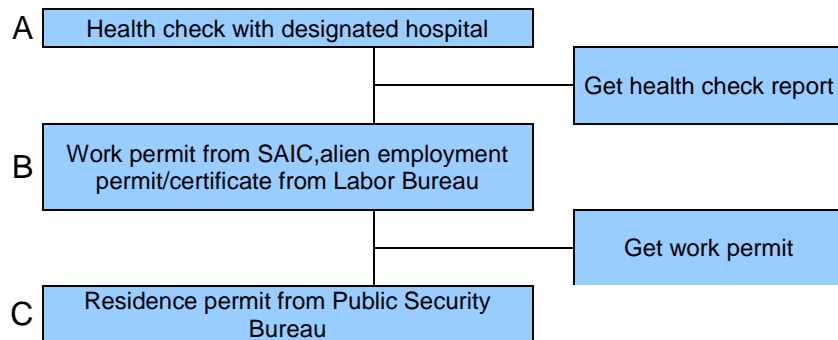
- Complete residence application procedures with local public security bureau by presenting the registration certificate, representative certificate and approval certificate
- Apply to open a bank account by presenting registration certificate and approval certificate to local foreign exchange administration
- Apply to Customs for permission to import office equipment, daily necessities and transport vehicles for use by the representative office and its personnel
- Complete tax payment registration procedure at local tax office
- Appoint Foreign Enterprises Service Company or "FESCO" to recruit local staff

Rep Office Registration Procedure:

Representative office



Procedures for Chief Representative's permits



* Notes - there are some regional variations to this process

1. Shenzhen - SAFE registration/approval not required

2. Guangzhou - lease agreement does not need to be notarized; customs registration usually not required; foreign exchange account not required.

3. Beijing - only commercial buildings can be used as registration address; some minor differences to registration of leasing agreement.

New Developments for Rep Offices

The regulatory landscape for Representative offices has been rapidly changing in the last years. Not too long ago Rep offices were set-up vehicle of choice. However in recent years their popularity has been rapidly decreasing in recent years. While it is still permitted to open a Rep Office, and for some industries such as finance, might be the only choice, for the overwhelming majority of industries it is permitted to have a wholly owned subsidiary in China. The attitude of the Chinese authorities towards rep offices is also increasingly less benevolent, as all of the recent changes have not been in favor of Rep offices and intend to decrease their popularity. Such measures include:

- Increase of taxation (see below sample calculation)
- Renewal of Business registration on an Annual Basis (used to be every 3 years)
- A Rep office shall have no more than 4 representatives in China (including the chief representative).
- Foreign company must have a 2-year history in order to establish a Rep office

A more comprehensive overview of changes can be found under: <http://law.wkinfo.com.cn/document/showarticle?aid=NjAwMDAwMDAwODM=&collection=article>

Sample calculation Rep Office

Contrary to common belief, rep offices are subject to **income tax** in China. As rep offices per se are not allowed to engage in profit making activities, the taxation is based on the expenses, assuming a certain profit rate to calculate the taxable income. To correctly calculate the tax burden all expenses incurred by or related to the representative office must be included in the office expenses. The expenses include the rental, transportation, telephone, salary, office purchases, entertainment, etc., regardless of whether they are paid from the RO or directly from its head office.

Additionally Rep offices also face a **business tax/VAT** on their income.

Fictional Representative Office monthly expense sheet

	Expense	Amount RMB
1	Office rental and management fee	10000
2	Salary for chief representative	24300
3	Salary for two local employees (RMB4,000 and RMB10,000)	14000.
4	FESCO Fee and social insurance for two local employees	3444
5	Other miscellaneous (i.e., telephone, office utilities, etc.)	6000
6	Individual Income Tax for Chief Representative 4666.67 for local employees 1322.32	5989
7	Total expenses	63733

Calculation Formula:

Income = Expenditures / (1 – deemed profit rate – business tax rate)

Amount of income tax = Income * deemed profit rate * enterprise income tax rate

Amount of business tax = Income * business tax rate

Total tax = income + business tax

In recent years there have 2 major changes effecting the taxation of Rep Offices:

- In 2010, the deemed profit rate was increased from 10% to 15%
- in 2013 the VAT was reformed nationwide raising the business tax from 5% to 6%.

To illustrate the effects on the tax burden I take above expense sheet as a calculation basis

Before 2010 (nationwide)

Deemed profit rate = 10%

Business tax rate = 5%

Enterprise income tax rate = 25%

Income = 63733 / (1 – 0.1 – 0.05) = 74980

Income Tax = 74980 * 0.1 * 0.25 = 1874.5

Business Tax = 74980 * 0.05 = 3749.0

Total Tax = 5623.5 or **8.8%**

2013: Deemed Profit Rate Increase and newVAT Rule

Deemed profit rate = 15%

Business tax rate = 6%

Enterprise income tax rate = 25%

Income = 63733 / (1 – 0.15 – 0.05) = 79666.25

Income Tax = 79666.25 * 0.15 * 0.25 = 2987.5

Business Tax = 79666.25 * 0.06 = 4780

Total Tax = 7767.5 or **12.2 %**

3. Joint Ventures

Equity joint venture. An EJV, is organised as a limited liability company, is a separate legal entity established by one or more foreign and one or more Chinese investors. Ownership and the share of profits and losses are determined based on the respective contributions to the registered capital of the EJV.

Generally, the minimum level of foreign participation in an EJV is 25%. There is no upper limit on foreign participation. Capital can be contributed in the form of cash, with foreign currency converted into renminbi at the exchange rate announced by the SAFE on the day the funds are submitted. In certain cases, capital may be contributed in the form of tangible assets (eg equipment, buildings and other material) or intangible assets (eg industrial property rights and know-how). When participants in an EJV contribute tangible or intangible assets, their value is determined jointly by the participants or by a third party designated by the participants, generally a China-registered accountant.

There is no official upper percentage limit per se on the amount of intangible assets that can be provided by a foreign partner. However, as the new corporation requires a minimum cash contribution of not less than 30% of the JV's total registered capital, it is unlikely that any contribution of intangible assets could exceed 70% of the registered capital. Partners must pay their contribution within a timetable fixed in the contract. Failure to make capital contributions on time may lead to cancellation and compulsory surrender or revocation of the business license.

The governance of an EJV is different from that of corporations in the West. Investors hold equity interest, but no stock. Voting authority is vested in the board of directors rather than the shareholders. The directors are appointed by the investors and, in general, reflect the ratio of the capital contributions of the partners. EJVs generally have a limited duration, typically 30 years.

Contractual or co-operative joint venture. A CJV differs from the EJV in two fundamental ways. A CJV does not have to be a separate legal entity, and even if a CJV is not incorporated as a limited liability company in its own right, it may elect to be taxed at the entity level. In most cases, a CJV elects to be treated as a taxable entity rather than a flow-through primarily in order to have more clarity of tax treatment. A CJV that is incorporated as a limited liability company is subject to tax at the entity level. The ownership and profits/losses are not necessarily shared based on equity contributions (as in the case of an EJV) but on the basis of a contractual agreement. The CJV thus may provide more flexibility with respect to profit-sharing and risk-taking among the partners. For example, the shareholder(s) may be guaranteed a certain amount of fixed annual return without regard to the actual performance of the CJV.

Capital is contributed in a ratio agreed by the parties to the CJV contract. Contributed capital may take the form of cash, land-use rights, technology (patented or unpatented), materials and equipment, trademarks and other property rights—essentially the same as for an EJV. As with EJVs, foreign partners' contributions in the form of intangible assets generally may not exceed 50% of the total foreign capital contribution or 20% of the CJV's total registered capital. Unlike an EJV, parties to a CJV may share profit in a ratio that differs from the ratio of capital contributions.

A CJV must have a board of directors or a joint-management committee. "Hybrid" CJVs tend to adopt management systems resembling those of the EJV; "true" CJVs tend to take the

more flexible form of a joint-management office. Under the latter structure, no general manager exists as such, although the parties usually appoint a legal representative. Generally, “true” CJVs, which do not have independent legal status in China, use the Chinese partner to enter into such contracts, under a grant of power of attorney by the foreign party.

Stage 1: Preliminary approval - Project Proposal

Upon reaching a mutual agreement, the Chinese partner will be solely responsible for the preparation and submission of the project proposal for preliminary scrutiny.

Generally, the authority will give an official reply within 20 days upon receipt of the proposal and other relevant documents. An approval or rejection letter will be issued to the applicant. The foreign party in a JV should request a copy of this document from the Chinese partner to ensure that the approval is consistent with the agreed terms of the project.

Upon receiving approval, the Chinese partner will proceed to register the name of the enterprise with the local Administration for Industry and Commerce (AIC).

The application will require basic facts about the project, information about the technological and technical processes, demand on energy and other resources, an assessment on possible environmental impact, prices of public goods or services involved, the means of capital contribution and financing, and a list of the equipment to be imported and the amounts required.

The relevant documents for submission include enterprise registration certificates of the Chinese and foreign investors, credit certificates, letter of investment intent, and an environmental impact assessment report issued by the environmental protection administration.

Stage 2: Formal approval - Contracts, Articles of Association

The contract, articles of association and other relevant legal documents for establishing the JV will be signed by both parties and submitted by the Chinese partner to the provincial or municipal Ministry of Commerce for approval. After the contract and articles of association are approved, the same partner would proceed to apply to the provincial or municipal Ministry of Commerce for an approval certificate.

Chinese law views the joint venture contract as the fundamental document for the establishment of the venture. The contract must meet the conditions stated in China’s joint venture law (for equity JVs) or cooperative enterprise law (for cooperative JVs). The preliminary project approval documents are included as appendices when the contract is submitted for formal approval.

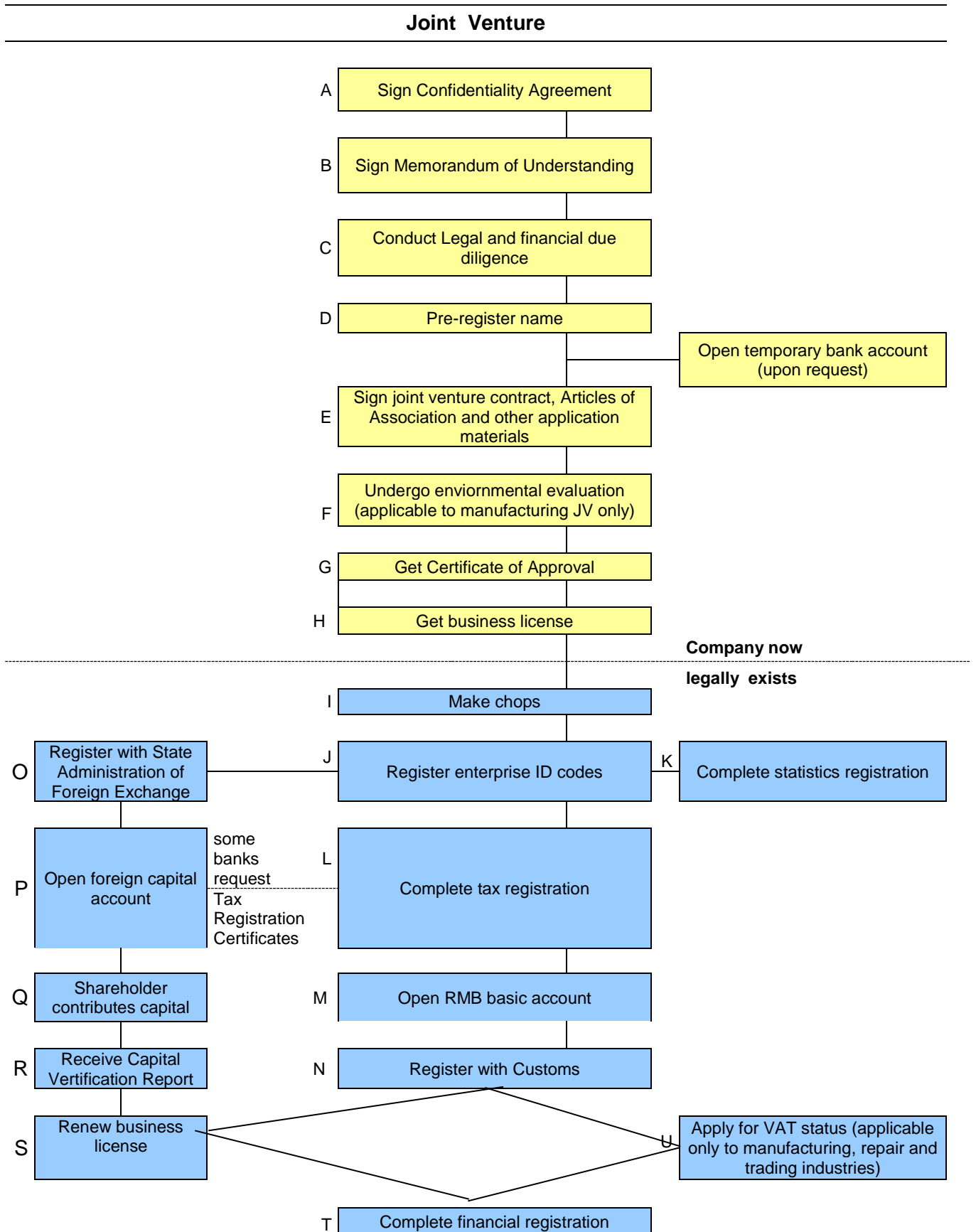
The documents required include the application letter for establishing the JVs, a feasibility study report (if any) and approval documents for the project, an application for registration of the name of the enterprise with approval from the provincial or municipal AIC, written comments on the project by various government departments such as environmental protection, fire services, health and land administration, business licenses of the parties concerned and certificates of their legal representatives, contract and articles of association duly signed by the legal representatives of the JV parties, and the list of Board of Directors.

Stage 3: Business License

JVs should register with the local AIC and apply for a business license within 30 days upon receipt of the approval certificate. The local AIC will then issue the business license within 10 working days to projects that have passed the examination. The date the business license is issued will be considered the official date of the enterprise's establishment.

Having acquired the business license, the JV has to finish up with procedures such as applying for an official seal and enterprise code, opening a bank account, and registering for tax payment and customs declaration with the local public security, technical supervision, taxation, customs, finance, foreign exchange administration, banking, insurance and commodity inspection departments.

JV registration procedure:



4. Overview of Different Entities

● = ideal
● = prohibited

Source JLJ	Business Activities *					Tax Treatment	Registration Process					Notes
	Import	Export	Domestic Commercial Activities	Service Activities	Manufacturing / Assembly Rights		Min. Registered Capital**	Duration of Entity***	Potential for Future Expansion of Scope†	Registration Complexity	Aprox. Time to Register‡	
Foreign Invested Enterprises	Representative Office											
		●	●	●	●	●	No capital required	1 year	●	●	1 Month	<ul style="list-style-type: none"> • Cannot Issue Invoice (no Transactions) • Intended for Market Research and Business Development Activities • Cannot directly hire Local Employees • Business registration must be renewed annually • Taxed on Expenses (aprox. 12 %)
	Service	●	●	●	●	●	30,000RMB	30 years	●	●	2 Months	<ul style="list-style-type: none"> • Products may only be sold coupled with services but must constitute a minority of revenues
	Manufacturing	●	●	●	●	●	30,000RMB	50 years	●	●	3 Months	<ul style="list-style-type: none"> • Distribute products manufactured in-house • Additional time may be needed for special licenses
	In't Trading	●	●	●	●	●	30,000RMB	30 years	●	●	2 Months	<ul style="list-style-type: none"> • Must be registered in a Free Trade Zone • May require Import / Export agent for import activities • Expansion to Manufacturing & FICE available
	FICE	●	●	●	●	●	30,000RMB	30 years	●	●	3 Months	<ul style="list-style-type: none"> • May be authorized for Retail and / or Wholesale • Franchising and Direct Selling available through approval • Commercial Activities are limited to like products
	Specialized Corporate Formations											
Investment Holding RHQ	●	●	●	●	●	30,000,000USD	50 years	●	●	6 Months	<ul style="list-style-type: none"> • provides management & corporate services to investments • Incentives can be negotiated with local government • M&A Activities are allowed • May include R&D center 	
Management RHQ	●	●	●	●	●	2,000,000USD	50 years	●	●	3 Months	<ul style="list-style-type: none"> • Limited management and corporate services for investments • Incentives can be negotiated with local government (but not as optimal as Investment RHQ) 	
R&D Center	●	●	●	●	●	2,000,000USD	30 years	●	●	3 Months	<ul style="list-style-type: none"> • Incentives may be negotiated with local government • Must maintain a minimum of 80% of staff with advance degree 	

*Denotes activities that may generate revenue streams for the entity.

**This reflects the minimum as stated in China's Company Laws and does not guarantee approval. Investors should invest enough to sustain operations until their projected break-even point.

***This reflects the maximum duration the entity may be approved by the government. All entities' licenses may be renewed before expiration.

† Capability of the entity to expand to Include additional capabilities (i.e., Manufacturing entity expands to Include FICE capabilities; Distribution FICE expands to include franchising and retail)

‡ This timing assumes all preapprovals have been obtained and all documents are ready to be submitted to the approval authorities.

5. Concluding Remarks

Experience shows that a company set-up in China can turn out to be a bureaucratic marathon, moreover the exact regulations can differ within China depending on the provincial and municipal rules and regulations. From the point of view of the Swiss Business Hub when contemplating a company set-up in China, it is highly advisable to seek the help of a local expert in this field. This can save a lot of time and energy that is often needed elsewhere during the company-setup process. Should you have questions or require more information, feel free to contact us.

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