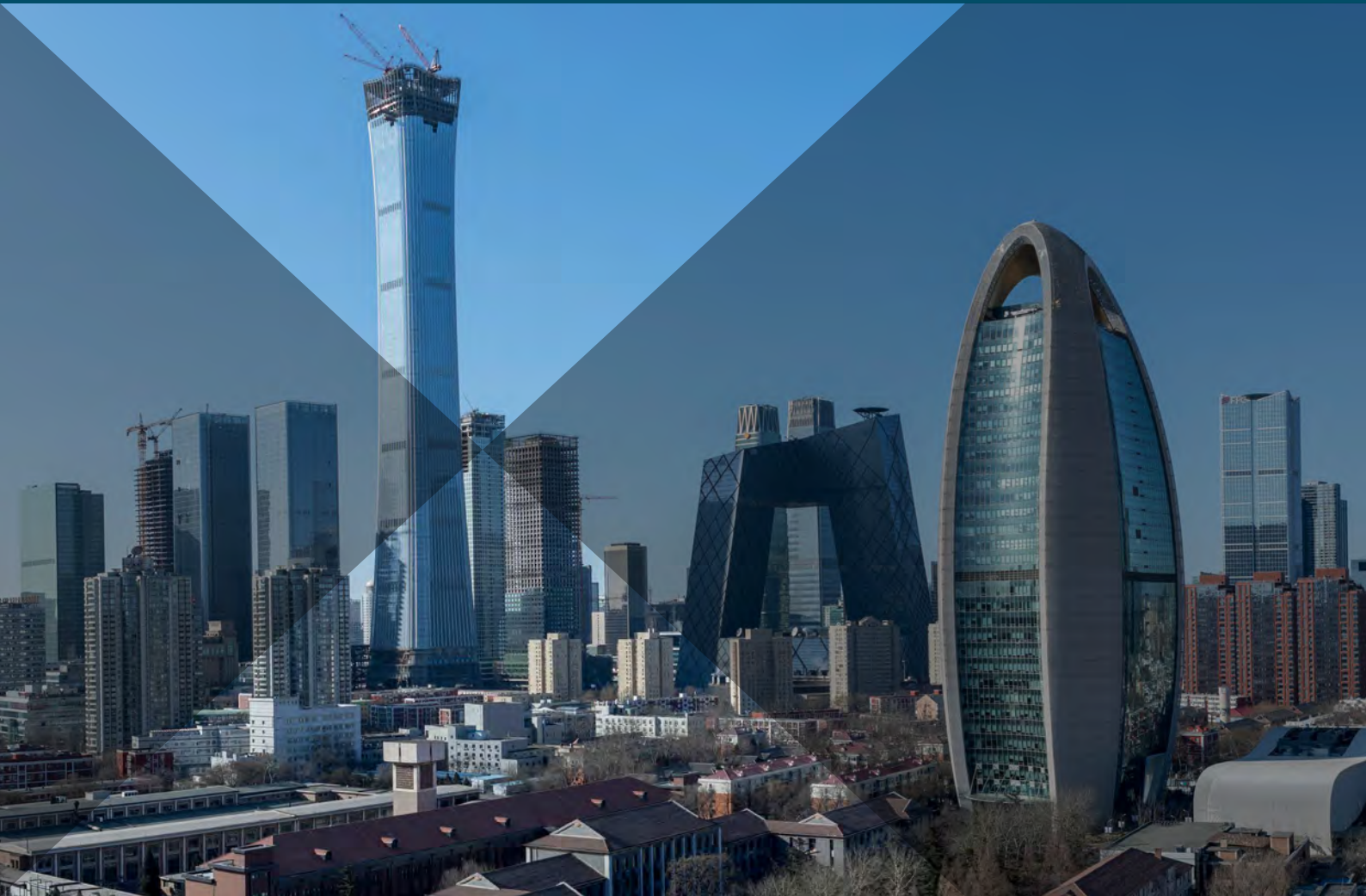


THE COMPLETE GUIDE TO DOING BUSINESS IN CHINA

2023 Edition



MOORE MS ADVISORY



INTRODUCTION



INTRODUCTION

The business landscape in China over 2022 was expected to be shaped by a range of factors, including geo-political challenges, domestic policy reforms and changes in consumer behavior. While this all still played a role, the overshadowing theme cast over 2022 was the implementation of restrictions and the widespread lockdowns that occurred across the country.

With the restrictions now in the rear view, many businesses are focused on looking forward, with several reasons and opportunities to be optimistic about. One of the main reasons remains to be the expected growth rate of the economy, despite slower expected growth than previous years. Growth amidst the global challenges where some other major economies are not forecasting growth.

China has also showed strong indications and commitment to becoming more open to foreign investment, as expressed by the new vice premier, Ding Xuexiang. For many who expected China to turn inward and become more self-reliant, the Chinese government pledges to reduce market entry barriers and fast track the development of the digital economy in an effort to spur new ideas and innovation.

Along with encouraging investment, as the focus shifts to more high value added industries, opportunities in innovation and sustainability presents many new opportunities for businesses. With the many challenges surrounding the global economy, those businesses who are agile and adopt a strategic approach are likely to achieve success in this dynamic market.



Raoul P.E. Schweicher
Managing Partner

About Moore MS Advisory

Who we are?

Moore MS Advisory is a financial advisory firm based in China which has affiliations with Moore Belgium and is a member of the Moore Global Network.



What we do

For more than a decade we have provided support to foreign companies across an array of different industries, in China and Hong Kong. Our comprehensive set of services include assurance and auditing, tax advisory, corporate services and more.



Our goal

We specialize in serving SMEs and large multinationals who have offices or business queries in China and Hong Kong. We aim to assist foreign enterprises by providing a full range of transparent, compliant and sustainable financial services to each one of our clients.



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Table of Contents

COUNTRY PROFILE	6	TRANSFER PRICING	58
Government	10	The Chinese Transfer Pricing Framework	60
Economy	11	Transfer Pricing Documentation in China	61
Legal/Judicial	11	CUSTOMS & TAXATION	64
FDI & COMPANY STRUCTURES	12	The Chinese Customs Environment	66
Foreign Investment Law	14	Tax Implications - Imports	68
Negative List And Encouraged Industries	15	Tax Implications - Exports	69
Company Structures	16	Bonded - Special Economic Zones	70
Corporate Establishment Procedures	20	Customs Declaration Procedures	72
Important Considerations	25	HR & PAYROLL	74
Changing Company Structures	28	Hiring Staff in China	76
Company Liquidation	30	Leave Policies	78
Considerations When Liquidating	31	Payroll Administration	78
Liquidation Process: Essential Steps	32	Termination of Employment	81
COMPLIANCE	36	Visa Policies	83
Recurring Compliance Requirements	39	BANKING & FINANCING	84
Fapiao Management	40	The Chinese Banking System	86
Company Chops & Key Documents	40	Domestic vs International Banks	87
Bank Account Management	43	Types of Bank Accounts	88
Corporate Social Credit System	43	China's Foreign Exchange Regulations	89
ACCOUNTING & ANNUAL AUDIT	44	International Transactions	90
Chinese Accounting Standards	46	Intercompany Loans	90
Chinese Accounting Standards vs IFRS	47	PROFIT REPATRIATION	92
ERP Systems and Data Storage	48	Dividend Distributions	94
Annual Audit In China	48	Intercompany Payments	95
TAXATION	50	Key Considerations	97
Direct Taxes/Tax on Income	52	FINAL THOUGHTS	98
Indirect Taxes/Taxes On Transactions	55	MOORE MS ADVISORY	99
Consumption Tax	56		
Surtaxes	56		
Other Indirect Taxes	57		



COUNTRY PROFILE



COUNTRY PROFILE



5 Reasons to do Business in China

1. Extensive involvement in global trade for both import and export activities
2. Boundless consumer market of over 400 million young consumers
3. Global leadership in innovative technologies
4. Transitioning economy with changing developmental goals and industry focus
5. Extensive support from the local Chinese government that help with entrepreneurship and innovation endeavors



Top Imports

Electric components
Machinery parts
Integrated circuits
Computer parts
Oil and mineral fuels
Optical and medical equipments

Prominent Industries

Agriculture
Manufacturing
Banking
Technology
E-commerce
Infrastructure
Insurance

Population
1.4 billion



GDP
per capita
\$10,434



Corporation
Tax
25%

Exports
\$2.49 trillion
Imports
\$2.14 trillion

Currency
Renminbi
RMB

Major cities
Beijing
Shanghai
Guangzhou
Shenzhen
Chongqing

Language
Mandarin
中文

Urbanization
61.4% of total
population

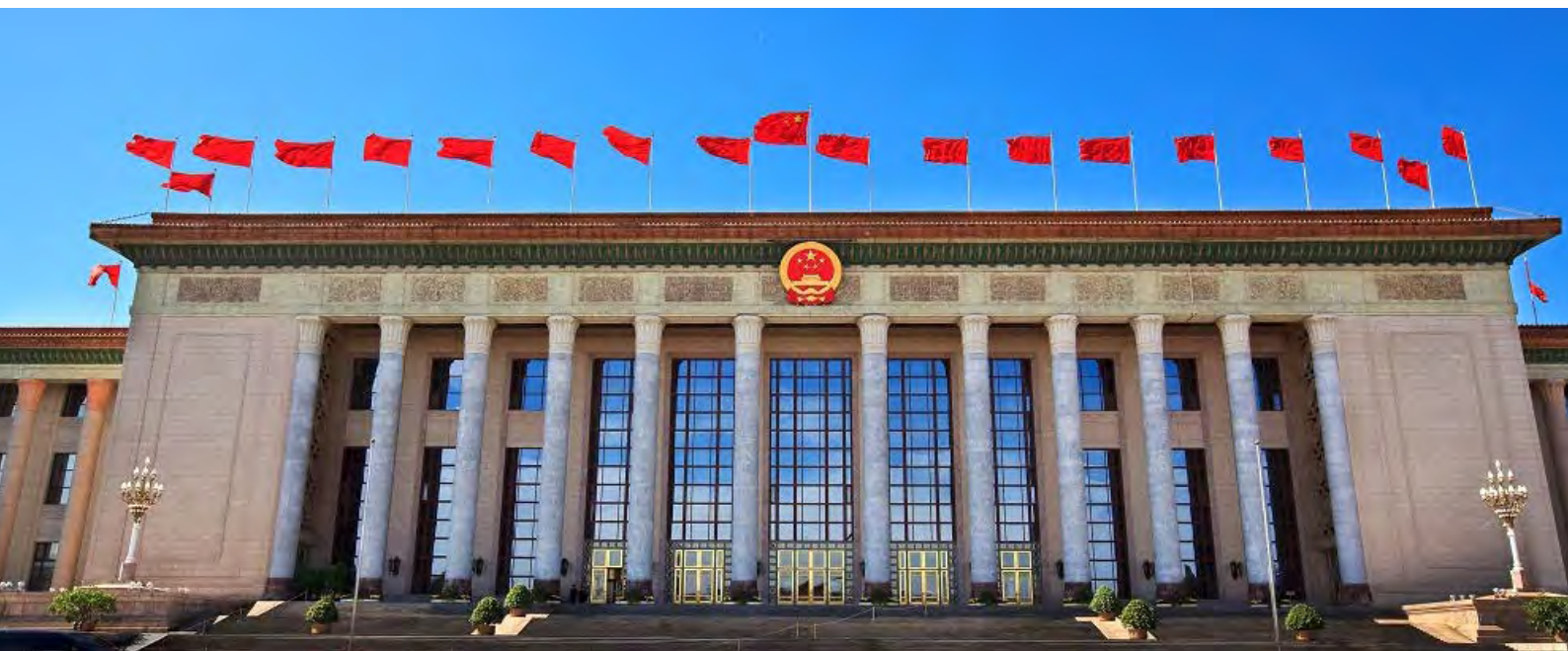
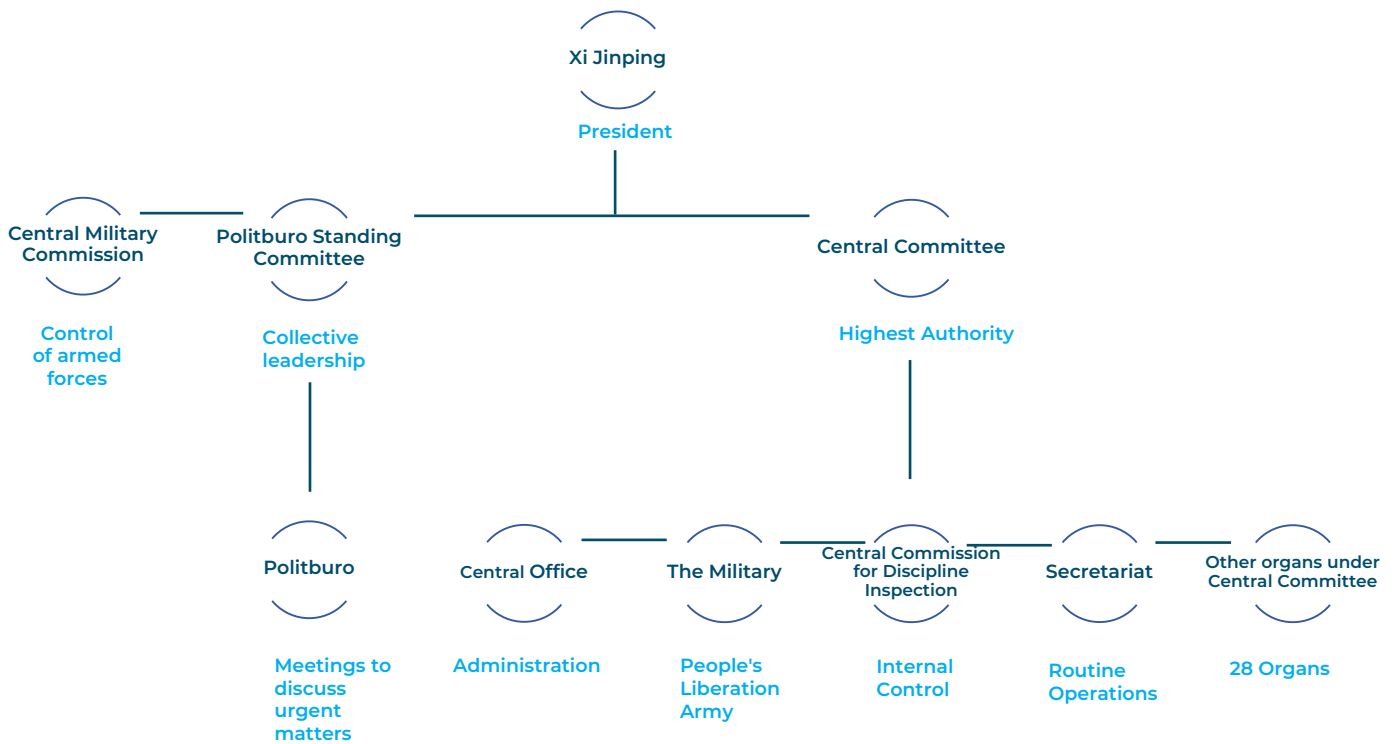


GOVERNMENT

The Chinese Communist Party (CCP) is the central political authority with comprehensive control over executive, legislative, military and the judicial system. The CCP counts over 89 million members and therein the Central Committee is the highest authority and comprises important leaders of the CCP.

The National People's Congress (NPC) is the national legislature of the People's Republic of China, and can be considered the country's parliamentary body with almost 3,000 members, whom formally have the right to enact and amend basic legislation, oversee enforcement of the constitution and elect and appoint members of central state organs. Another important organ of state is The State Council, which enacts policy and presides over Chinese governmental departments. The State Council can be considered the equivalent of the cabinet and formally sits under the NPC.

The president of the People's Republic of China, currently Xi Jinping, is the paramount leader of the county. Whereas the office of president as head of state is largely ceremonial, the president derives most of its powers from simultaneously heading three additional political and state offices, namely that of General Secretary of the Central Committee, Chairman of the Central Military Commission and most importantly General Secretary of the Chinese Communist Party.



ECONOMY

Following the founding of the People's Republic of China in 1949, the country maintained a centrally planned economy which has largely shielded itself from foreign investment. From 1978 onwards under the leadership of Deng Xiaoping, the country has made significant economic reforms toward trade liberalization as well as the implementation of free-market protocols. Since the opening up of its economy in the 1970s, China's annual GDP growth averaged around 10%, which has been described by the World Bank as "the fastest sustained expansion by any major economy in history". As a result of this continued growth, China is set to become the largest economy in the world in the next few years, and is currently the largest manufacturing economy and a major exporter of goods. Since 2010, China's annual GDP growth has been slowing down, which also resulted in a shift in policy with increased focus on domestic consumption and innovation.

The Chinese economy can be further characterized as a socialist market economy, including elements of a market economy in combination with state economic planning. State economic planning occurs via successive Five-Year Plans, which have been issued by the Chinese government since 1953 and the 14th Five-Year Plan will come into effect in 2021. Although State-Owned Enterprises continue to play an important role in the Chinese economy, they are responsible for approximately one third of the country's total GDP, whereas income from private enterprises makes up the remaining two thirds respectively.

China was originally known as the world's factory, however through a combination of technological advancements, increased spending power, its improved position in the value chain, and currency appreciation, China aims to move away from a manufacturing economy towards a consumer-based economy. Despite industry making up approximately 50% of its total GDP, over the past few years we observe a clear trend towards technological innovation with companies such as Huawei, Tencent and Alibaba and their affiliates becoming globally recognized technology giants. Additionally, China's banking sector is the world's largest based on assets and is dominated by four state-owned commercial banks incl. the Industrial and Commercial Bank of China (ICBC), China Construction Bank (CBC), Agricultural Bank of China (ABC) and Bank of China (BoC) whom together account for 15% of assets of the top 100 global banks. China is also the world's largest buyer of several commodities, incl. soybeans, copper, steel and crude oil, which fuel major industries such as the construction, real estate, engineering and manufacturing industries.

LEGAL/JUDICIAL

Officially the Chinese legal system is based on the model of Civil Law in which the Constitution of the People's Republic of China provides the highest authority, followed subsequently by national laws, administrative regulations, departmental rules and finally local regulations.

The judicial system consists out of the People's Courts, which include the Supreme People's Court, The Special People's Court and Local People's Court. In recent times, we have seen the addition of two new types of courts, namely the Intellectual Property Court and the Shanghai Financial Court – where the latter two exercise jurisdiction over IP and financial disputes respectively.

A large container ship is docked at a port, with its deck covered in stacks of colorful shipping containers. In the background, a large gantry crane stands against a dramatic sunset sky with orange and yellow clouds. The ship's hull is white with a red stripe along the waterline. The water in the foreground is dark blue with some ripples.

FDI & COMPANY STRUCTURES



With the amount of foreign investment China has received over the past few years, more companies are looking to gain a better understanding of how to invest and the most appropriate investment vehicle that matches their business needs.

In this chapter we provide an overview of the available investment vehicles as well as an understanding of the Foreign Investment Law (FIL), which has been promulgated to regulate foreign investment into China.



FOREIGN INVESTMENT LAW

Over the past few years, China has actively sought to develop a legal framework to govern foreign investment in Mainland China. The implementation of the new Foreign Investment Law (FIL), as of January 1st 2020, brought a unification of the previously existing and distinctly separate laws on foreign investment. In particular, the new Foreign Investment Law repealed the Wholly Foreign-Owned Enterprise Law (1979), the Chinese-Foreign Cooperative Joint Venture (CJV) Law (1988), and the Chinese-Foreign Equity Joint Venture (EJV) Law (1990). The FIL came into effect on the 1st of January 2020.

The aim of the new Foreign Investment Law was not only to update the above legislation, but also to promote equal treatment of foreign and domestic enterprises and thereby increase foreign investment into China. This equal treatment should be accomplished through the principle of National Treatment, which implies that except for specific requirements pursuant to the Negative List for Foreign Investment into China, Chinese authorities should treat foreign investors equal to domestic investors.

Foreign-invested enterprises (FIEs) established before January 1st 2020, are provided a 5-year transition period to update their organizational structure according to the newly prescribed requirements (notably impacting CJVs and EJVs); whereas investment into China as of 2020 must comply fully with the PRC Company Law, the PRC Enterprise Law and other applicable legislation.

The Foreign Investment Law also introduced 'The Implementing Regulations', and highlights Investment Promotion, Investment Protection, Investment Administration (including the so-called Negative List, which is further discussed on the next page) and Legal Liabilities.



NEGATIVE LIST AND ENCOURAGED INDUSTRIES

Industries in China are regulated and administrated by several so-called 'Negative Lists', which governs and provides guidance to business sectors and industries and where possible restrictions and prohibitions can exist. The Foreign Investment Negative List (FINL) is one of these lists and specifically enumerates sectors where foreign investment is restricted or prohibited. In addition to the FINL, a separate Negative List for the Free Trade Zones in China exists, which includes fewer restricted industries to foreign investment.

The investment vehicle a foreign investor can choose to enter the Chinese market with can vary, depending on whether a particular industry has been stipulated within the Negative List. If the industry is included in the Negative list, it means that some investment vehicles are not permitted, whereas legal structures in a number of industries require additional approvals from the Ministry of Finance and Commerce (MOFCOM). As a result, the Negative List also impacts the activities which FIEs can perform in their business scope.

The principles of the Negative List were incorporated into the provisions of the new Foreign Investment Law. On March 25, 2022, the Negative List was further reduced, continuing a gradual trend on improving market access for foreign investors.

The updated Negative List cuts the number of industries with restrictions from 123 in 2020 to 117 at present. Although the latest revisions lower the total number of industries facing restrictions and notably offering targeted opportunities in the financial sector, also new restrictions in the news media sector were introduced.

On the other hand, the Chinese government issued an Encouraged Industries Catalogue which provides incentives for foreign investments in specific industry sectors. Foreign investors whom engage in investment in these industries can experience reductions/exemptions of tariffs, increased accessibility to land and preferential Corporate Income Tax (CIT) rates among others. The 2022 version of the Encourage Catalogue has come into effect on January 1, 2023 and continues to focus stipulates on three main areas in which the Chinese authorities welcome Foreign Direct Investment (FDI): high-end manufacturing and the production-oriented service industry as areas in which the Chinese authorities welcome Foreign Direct Investment (FDI). The 2022 Encouraged Catalogue serves 3 main purposes:

- High-end manufacturing. Boosting foreign investment in manufacturing to upgrade China's industrial and supply chains.
- The production-oriented service industry. Promote the integration of the service and manufacturing sectors.
- Stimulate investment in China's central, western and northeastern provinces.

COMPANY STRUCTURES

Understanding how to access the opportunities that exist in China can be confusing for most and deciding on the right market entry vehicle is one of the most important decisions for foreign businesses exploring entry into China. The appropriate mode of entry depends on multiple parameters, with the intended activities and industry being the most important considerations. Under the new Foreign Investment Law, four primary investment vehicles can be established by legal persons or non-legal persons, namely: Wholly Foreign-Owned Enterprises (WFOE, also known as WOFE), Joint Ventures (JV), Representative Offices (RO) and Variable Interest Entities (VIE). Some less utilized investment vehicles include holding companies, regional headquarters and foreign-invested joint stock companies but are excluded from the overview below due to their limited application in scope and practice.

WFOE

A Wholly Foreign-Owned Enterprise or WFOE is the most common and generally preferred investment vehicle of foreign investors. A WFOE is a Limited Liability Company (LLC) which is fully owned by the foreign investor and thus provides the investor full control/independence in matters of operations, strategy and HR.

Three different types of WFOEs can be distinguished, namely:

- ▶ The Consulting WFOE: Licensed to operate as a consulting business within the service industry.
- ▶ Trading WFOE: Licensed to conduct trading, wholesaling, retailing and franchising activities in China. These types of companies are required to make an additional registration at Customs to be able to import/export goods in/from China.
- ▶ Manufacturing WFOE: Licensed to manufacture or assemble products. Although the process of registering this type of WFOE is similar to other WFOE registrations, an additional requirement is needed for an environmental impact assessment to be performed.

Representative Office

A Representative Office (RO) is not a separate legal entity but rather a type of “branch” of the head office (“liaison office”). Although a Representative Office does not have any registered capital requirements, a defining characteristic is its limited business scope. They are only allowed to conduct marketing & research activities for the headquarters, thus meaning they cannot engage in any commercial activities, they cannot issue fapiao and cannot independently hire local Chinese staff. In addition, Representative Offices are required to pay Corporate Income Tax based on their expenses, which they are unable to offset as they are not allowed to engage in any commercial activities.



Joint Venture

Similar to a WFOE, a Sino-Foreign Joint Venture (JV) is a Limited Liability Company. However, in a Joint Venture structure, a foreign investor partners with a Chinese company or individual (hence the name Sino-Foreign JV). Generally, there are two reasons why companies want to establish a Joint Venture in China:

1. Accessing a restricted industry sector in which foreign investment is only permitted through a Joint Venture.
2. Utilizing the existing network of a Chinese partner with local market knowledge and established contacts.

Management of Joint Ventures can be more complex for companies with limited international experience. Within the Chinese corporate environment, shareholders cannot always exercise direct influence on the activities of their Chinese subsidiary, and instead the Board of Directors and in particular the Legal Representative of the Chinese subsidiary holds the authority to make principal decisions. Therefore, in the case of a foreign investor holding a minority stake on a board of a Joint venture, successfully operating the JV may prove difficult. The Foreign Investment Law defines two distinct types of Joint Ventures, namely

- ▶ Contractual Joint Ventures (CJV).
- ▶ Equity Joint Ventures (EJV).

Note: the governing structure and operating rules of Joint Ventures will have to comply (within 5 years) with the provisions of the Company Law following the implementation of the Foreign Investment Law.

Branch Office

Branch Offices allow a Chinese subsidiary to engage in business operations outside its place of residence, however, they are not a separate legal entity and thus are an extension of an existing subsidiary, for which the Chinese subsidiary assumes all liabilities. Therefore, to establish a branch office in China as a foreign company it is a prerequisite to have an existing subsidiary.

The business scope of a Branch Office in China is limited by the activities listed in the business scope of its parent company and it cannot independently import/export goods. On the other hand, a branch office faces fewer compliance requirements compared to a separate legal entity, such as a WFOE.

Establishing a branch office is the only fully compliant solution to expand a company's presence to another city in China where it intends to hire local Chinese staff. Furthermore, the establishment of a branch office of an existing Chinese subsidiary offers a relatively simple and cost-effective method to expand the company's presence throughout China, in comparison to establishing an additional Chinese subsidiary.

Variable Interest Entity

An option for foreign investors to invest in a restricted industry is via a so-called Variable Interest Entity (VIE) structure. A VIE is a structure where a foreign business enters into a contractual relationship with a Chinese domestic company which has the necessary approvals and licenses to operate in a specific sector, where control over the operations and management relies on the contractual agreement(s) in place between the foreign business and the domestic Chinese company.

It is important to note that the VIE structure is not officially approved according to PRC law and regulation, yet thus far, its operations have been allowed by Chinese authorities. The VIE structure has come under increased scrutiny as of late from Chinese regulators and due to its impending potential structural risks, it is not commonly utilized in practice.

STEPS TO INCORPORATE A COMPANY IN CHINA

Once a foreign investor has decided to set up a company in China it must consider the applicable procedures and regulations to establish a Chinese subsidiary and develop a business plan to build a proper foundation for its intended operations in China. As such, this section will first detail the important aspects of developing a market entry plan and thereafter will discuss the step-by-step process to incorporate a company in China.

MARKET ENTRY PLANNING

Although it is essential to consider the optimal market entry vehicle to operate in the Chinese market, a foreign investor firstly must develop a basic understanding of the Chinese market, assess the feasibility to operate in its chosen industry and review other important considerations related to its intended mode of operations. Whereas a wide variety of elements may be considered, the depth and breadth of an investor's market entry planning may vary depending on its requirements. In general, we advise to consider the following elements prior to the company incorporation process or as part of the preparatory phase while considering the structural details of the intended Chinese subsidiary:

1. Market Research

A foreign investor may perform market research in order to attain further industry insights and obtain a comprehensive overview of the local market. Such market research could include an analysis of legal- and macroeconomic factors, identification of competitors, suppliers and other industry players, identification of possible partners and distribution channels as well as sales and distribution channels, and identification of the

2. Feasibility Assessment

After an investor has concluded it intends to set up its own operations in China, a subsequent step is to evaluate the market entry requirements and specific license requirements within your industry.

3. Legal Investment Vehicle

Once a foreign investor has decided to enter the Chinese market it is important to determine the optimal business structure or investment vehicle. The assessment of the most appropriate investment vehicle depends on the company's intended business activities as well as the aforementioned legal feasibility analysis.

4. Partner Search and Recruitment

It may be additionally required for the company to identify suitable partners that support the development of your China subsidiary and support with the execution of your China strategy. Such partners may include possible distributors or sales agents, as well as service providers such as financial advisors, legal advisors and other advisors.

In addition, an important consideration for the development of a local market is to assess whether it is required to hire local employees to fulfill the company's strategy and if so what are the most important positions to fill. The consideration to recruit people may already be important during the pre-establishment phase, for example a foreign company may trial the potential to sell in the Chinese market by using a dispatcher to hire qualified sales personnel on behalf of the headquarter.

5. Location Identification

Another important aspect for foreign investors is to consider the location of a Chinese subsidiary. Firstly, as the company must provide relevant materials for its registered address during the company's incorporation, but secondly as the location will further impact the company's operations in terms of costs, available talent pool, prospective partners and suppliers to work with etc. Identifying a suitable location is particularly important for companies engaged in R&D, assembly or manufacturing activities as these cannot be performed in all locations and may be subject to additional inspection and licensing requirements.

6. Identification of Sales & Distribution Channels

Prior to entering the Chinese market it would also be relevant for the investors to consider the sales and distribution channels the company intends to use to sell its products or services, and evaluate whether it believe the Chinese subsidiary can sustainably generate revenues to fund its own operations.

7. Trademarking & IP Protection

As China is using the 'first-to-file' principle with regards to trademarking and IP it is essential for foreign business engaged in doing business with China, even without its own entity, to register their respective trademarks and IP. In order to ensure optimal protection for the foreign investor it is advised to work with seasoned professionals to ensure proper registration in all relevant categories.



Comparison of Investment Vehicles:

	WFOE	JV	RO
Legal Status	Separate legal entity	Separate legal entity	Extension of HQ
Liability of Shareholder	Limited to registered capital	Limited to registered capital	Full liability
Registered Capital	No minimum requirement	No minimum requirement	No registered capital
Business Scope	Allowed to conduct consulting, trading and manufacturing activities	Allowed to conduct consulting, trading and manufacturing activities	Restricted to marketing and liaison activities
Commercial Activities	Allowed to engage in commercial activities and can issue fapiao	Allowed to engage in commercial activities and can issue fapiao	Cannot engage in commercial activities
Import & Export	Possible after obtaining an import/export license	Possible after obtaining an import/export license	Cannot import/export independently
Labor Employment	Can independently hire foreign/local staff	Can independently hire foreign/local staff	Cannot independently employ Chinese staff and maximum of 4 foreigners

COMPANY ESTABLISHMENT PROCEDURES

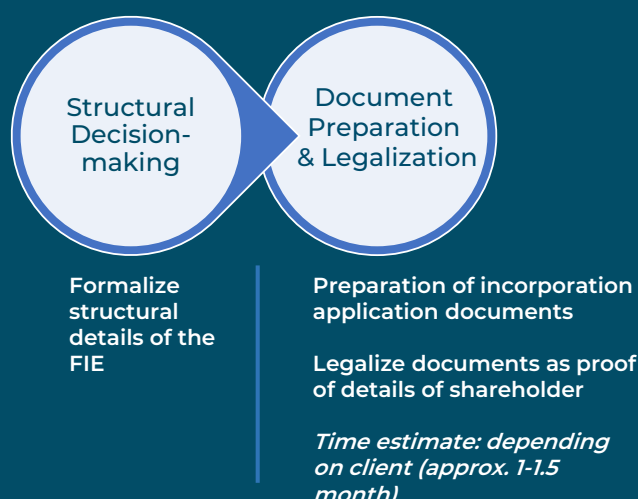
After a company has decided on the preferred investment vehicle to enter the Chinese market, it can commence with the corporate establishment procedures. In this section we discuss the step-by-step process of the corporate establishment procedures and important structural aspects to consider.

Company Establishment Procedures

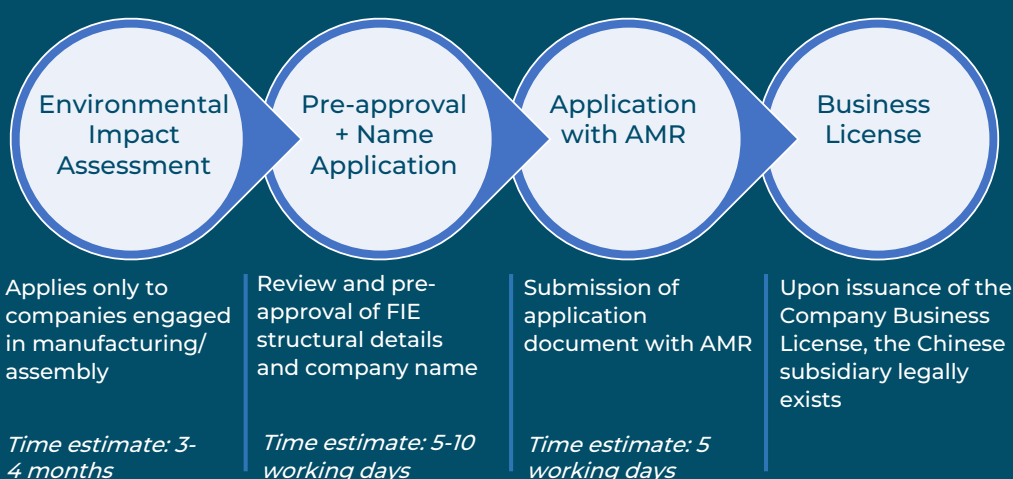
The establishment of a Foreign-Invested Entity in China is subject to various laws, regulations and governmental authorities. On average, the procedure to establish a fully operational legal entity in China takes 2 to 5 months to complete, but depends in part on the chosen investment vehicle and planned business activities. Although there are some variations in the establishment procedures depending on the chosen investment vehicle, such as with a manufacturing WFOE where an environmental impact assessment must be performed, the procedures generally include structural decision-making and document preparation, as well as pre and post Business License application procedures (see graphic below).

Table of the WFOE set up

1. Preparation phase



2. Pre-Business Licence



3. Post-Business Licence



1. Document Preparation & Legalization in Country of Shareholder

When establishing a legal entity in China several documents must be provided which provide evidence of the details of the investor, such as the incorporation and status of the shareholding company, which individuals have authority to sign documents on behalf of the company and the identity of key registered personnel.

Since China is not part of the apostille convention, documents from foreign countries are only legally valid in China when they are legalized by a Chinese embassy/consulate in a foreign country. The method to legalize documents varies per country but commonly includes the following steps:

- ▶ Notarization by a public notary
- ▶ Legalization by Foreign Affairs authority of the foreign country
- ▶ Legalization by the Chinese embassy/consulate in the foreign country

Because these procedures can be time-consuming, we advise starting the process of procuring these documents and completing the legalization procedures as soon as the decision to set up a subsidiary in China has been taken. Whilst documents are in preparation, the company can simultaneously decide on the structure details, as discussed in the next step.

2. Decision on structural details of the Chinese subsidiary

Before proceeding with the application procedures with the Chinese authorities, the following structural details must be decided upon:

- ▶ Company name in Chinese
- ▶ Company name in English (optional)
- ▶ Business scope
- ▶ Registered personnel
- ▶ Registered address
- ▶ Registered capital & total investment

It should be noted that all structural details are subject to approval by the Chinese authorities. In particular, the Chinese name and business scope will be critically reviewed. Therefore, we normally propose that several Chinese names are prepared, considering the possibility that the authorities will reject proposed names; and we advise that the process of drafting of a business scope may require discussion with the local Administration for Market Regulation (AMR) to define an acceptable business scope within the limits of the catalogue of permissible business activities

Environmental Impact Assessment

In case a foreign company intends to establish a subsidiary in China that will engage in manufacturing processes, including full manufacturing or assembly of final products, it will be required to perform an environmental impact assessment (or EPA). The purpose of the EPA is to assess the estimated impact which the operations of the intended manufacturing facility will have on the environment.

In order to successfully complete an environmental impact assessment, a licensed Chinese third-party is required to prepare an assessment report which includes an on-site environmental impact assessment and assessment of the manufacturing process. The level of complexity of the qualifications to meet the on-site assessment and the type of EPA report depend on the planned business activities.

The in-charge environmental protection bureau and AMR (during step 5) must provide approval for the planned business activities based on the EPA report that has been obtained. Since an environmental impact assessment can take up to 4 months to complete and is required to obtain approval to issue a manufacturing company's Business License, it is essential to find an appropriate manufacturing facility and to initiate the assessment at the earliest convenience.

3. Pre-approval and Name Registration

When all structural details have been decided, the company can file an online pre-approval for the structural decisions and company name registration. Although legalized documents are not yet required at this stage, the company is required to upload scans of the identification documents of the intended registered personnel as well as a copy of the lease agreement among others.

Upon review, the authorities may reject the pre-application if any of the structural details cannot be accepted for failing to meet prescribed (local) requirements. After correcting any possible issues in discussion with the AMR, the company can resubmit the application until it receives approval.

Once the pre-application is approved, the system will generate the official application documents, which must be printed and physically signed by the registered personnel. As the application documents in combination with documents evidencing details of the investor will be physically required during applications with the AMR, they must be couriered to China together.

4. Application with the Administration for Market Regulation (AMR)

Upon receipt of the signed application documents and legalized documents from the investor in China, the official application with the AMR can be lodged. Once the AMR has approved the application, the business license will be issued and at this moment the Chinese subsidiary legally exists, however, the entity is not operational yet.

After receiving the business license, the company can also apply for the electronic business license, which will be required for tax registrations in many regions across China. The electronic business license has the same validity as the paper version but can be used on a phone or tablet by issuing a QR code, or by scanning a QR code which provides all the necessary information.

5. Carving of Company Chops

After issuance of the business license, the company can proceed with the carving of the company chops, which serve as signatures on behalf of the company and can make documents binding (see section 3 on Compliance for a further explanation of company chops). The various company chops are required for the completion of subsequent application procedures.

6. Bank Account Opening

For any Chinese subsidiary to be fully operational, it will be required to inject capital and the following bank accounts:

- a. RMB Basic Bank Account – which is used for daily transactions.
- b. Foreign Capital Account – which solely serves to receive the company's capital via capital injection.

It should be noted that a foreign-invested enterprise is legally required to inject the full amount of registered capital within a 30-year period, meaning you are not required to inject all capital in at one time.

Before the Chinese subsidiary can use capital funds in China, it must be converted from the foreign capital account into RMB on the RMB basic account (see section 9 for more information on the Chinese banking system and bank accounts in China).



7. Tax Registrations

Any foreign-invested company in China is required to meet tax filing compliance requirements and therefore is required to commence with basic tax registrations within 30 days after the entity legally exists. In order to meet these legal requirements and to become fully operational, a company must apply for the following tax registrations:

- ▶ Basic registration with National and Local Tax Authority.
- ▶ Registration for General VAT Taxpayer Status – required to deduct input VAT from output VAT – or Small-scale Taxpayer Status.
- ▶ VAT invoice “Fapiao” registration – required to be able to issue fapiao (official Chinese invoice).
- ▶ Company registration at the Social Security & Housing Fund – required to meet the company’s obligations to pay contributions for social security and housing fund on behalf of its employees.

Foreign Experts Bureau Registration


If a Chinese subsidiary intends to hire foreign nationals, it must additionally complete a registration with the local Foreign Experts Bureau.

8. Import/Export License Application (if applicable)

If a company wants to be able to import and export goods, they must apply for an import/export license with the customs authority and obtain access to the E-port operator system. Furthermore, the company is required to complete a registration with the State Administration for Foreign Exchange (SAFE) in order to be eligible to receive funds or make payments for goods that have been exported and imported respectively.

9. Applications for Other Licenses (if applicable)

In several industries additional licenses may be required to operate, for example a food & beverage license, alcohol distribution license, and specific professional licenses (e.g. accounting).



From the moment the company completes the tax registration, it is required to complete monthly and quarterly tax filings.

IMPORTANT CONSIDERATIONS

When establishing a Chinese subsidiary there are a number of important considerations to consider in terms of legal considerations and the structure of the legal entity, which are further discussed below.

Registered personnel

Any foreign owned limited liability company in Mainland China must appoint a Legal Representative, an Executive Director or Board of Directors, a General Manager, and a Supervisor. It is required to determine those positions during the company establishment phase.

Legal Representative

The legal representative bears complete responsibility of the firm's actions and maintains full authority over the company chops. This means that this person is entitled to engage in any business activity on behalf of the company, but on the downside this person is held responsible by Chinese governmental authorities in case of any discrepancies (if a legal representative resides outside China this will remove such a risk, as authorities will not be able to hold this individual directly accountable).

The full details of the Legal Representative must be filed with the local AMR. The legal representative may be of any nationality and does not have to reside in China.

Executive Director/Board of Directors

A foreign-invested enterprise in China can be either managed by a Board of Directors or through a single Executive director. The board of directors must be comprised of no fewer than three and no more than thirteen members, and full details regarding these individuals must be filed with the AMR. One director among them is appointed as the Chairman who also serves as the Legal Representative and has the right to make binding agreements on behalf of the company.

It is up to the discretion of the investor to decide the management structure and thus the investor may choose to have a single Executive Director if the company operates on a small scale and has few shareholders.

General Manager

The day-to-day activities of a company in China are managed by the General Manager. This position does not have to be registered with the AMR. The Directors of an FIE can be of any nationality; however, corporations cannot be regarded as part of the board of directors, meaning only individuals can be appointed as Directors. There is no requirement stipulated in Chinese law that board meetings must be held within China.

This person can be either a member of the Board of Directors or another independent individual. Again, there is no requirement for this individual to have a certain nationality or to be a resident of China. However generally, FIEs appoint a Chinese national who does not serve on the Board of Directors and resides in China as General Manager. The General Manager has the authority to sign and chop agreements on behalf of the company, but usually requires prior approval from the Legal Representative by means of delegation. Delegation of such authority generally occurs via a combination of internal processes and are contained in the company's Articles of Association.

Supervisor/Board of Supervisors

A supervisor is responsible for supervising the conduct of the Board of Directors/Executive Director in order to protect the rights and interests of the shareholder(s). In practice, the supervisor of a company has no direct authority or responsibility, and usually serves a 'symbolic function' within the company.

An FIE in China is required by the Company Law to appoint at least one natural person as the supervisor, and this person can be of any nationality and reside in any place. The supervisor cannot be appointed simultaneously as the General Manager, Legal Representative nor occupy a Directorship position.

Authorized Representative

The shareholder(s) of a Chinese subsidiary represent the highest authority for the company, whose decisions regarding the company's operations are executed by the Legal Representative. The details of the shareholder are also filed with the local AMR.

The Authorized Representative(s), also called the representative(s) of the shareholder(s), is the individual or are the individuals who would sign a shareholder decision on behalf of the shareholder. Such a shareholder decision is required during the legal establishment but as well any major structural change of the Chinese subsidiary.

Appointing one Authorized Representative through a Power of Attorney during the corporate establishment phase will significantly simplify administrative procedures in China which require a shareholder decision.

The general understanding from the authorities is that the person(s) who signed the last shareholder decision must be the person(s) who signs any subsequent shareholder decision. In case the shareholder intends for a different individual(s) to sign the shareholder decision, the shareholder must provide relevant legalized documents from their home country proving this individual has the authority to sign on behalf of the shareholder.

Business scope

The business scope is an official description of the activities a company plans to engage upon in China. This business scope is mentioned on the business license of a company and is publicly accessible by any individual via the company registry on the website of the AMR.

It is important to note that a company is only allowed to conduct operations which are specified in its business scope. If a company performs activities outside of its business scope, it can be subject to fines, and in some instances, the company's business license can be revoked.

To determine which activities can be included within the business scope, the Negative List is used, meaning that foreign investments in all sectors should be allowed unless specified as either prohibited or restricted under the Negative List. However, the Chinese authorities generally encourage foreign investors to set up businesses in industries which contribute positively toward the economic development of China. Furthermore, the format of the business scope is limited to the official terminology of the Catalogue of available business activities.

We advise investors to carefully consider the business activities the company wants to engage upon in China when establishing the legal entity, but also consider any activities the company plans to engage in in the future, as the process of changing the business scope can be complex and time-consuming.

Registered address

All companies are required to have a registered address, of which proof must be provided during registration. Since it is a requirement during the company name registration procedure, you should have a lease agreement before submitting the documents for (pre-)application with the AMR.

In order for a registered address to be suitable it must satisfy the following two requirements:

- ▶ The address can be used for commercial purposes.
- ▶ No other company is registered at the intended address.

In the past many companies have used virtual addresses for their company registration, and subsequently execute actual work and activities from a different location. Theoretically, the Chinese law provides that a physical address needs to be arranged for the registered address, meaning that any company which utilizes a fake- or virtual address runs the risk of being blacklisted by Chinese authorities.

Registered capital and total investment

The registered capital refers to the total amount of equity or capital contributions to be paid fully by the shareholders of a foreign invested enterprise in China. This is generally a tax-free contribution which can be paid as either cash (foreign currency or overseas RMB) or contributed in technology, machinery, and/or other assets – where we recommend that the registered capital is paid in foreign currency.

In the past, it was required for any WFOE in China to contribute the registered capital within 2 years from the start of the company's operations. After reforms to the PRC Company Law which came into effect on 1st March 2014, companies now have the obligation to contribute the full amount of registered capital within a period of 30 years after establishment.

The total investment refers to the amount of funds which a foreign-invested enterprise needs to realize the company's production or operations as set out in their Articles of Association (AoA). A WFOE company also needs to specify in the AoA what the total investment contributed to the company would be.

The difference between the registered capital and total investment is that registered capital can be brought into China as a loan issued by the parent company, where the overseas parent company becomes the creditor of this loan. As such, this difference between registered capital and total investment is also known as the financing gap. The cap for any loan using the financing gap method is maintained by the following ratios (and cannot be exceeded):

Permitted ratios of registered capital vs total investment

Total Investment	Registered Capital	Company Loan	Minimum Registered Capital
Less than or equal to US \$3 million	At least 70% of total investment	Maximum 30% of total investment	No minimum required
Over US \$3 million - US \$10 million	At least 50% of total investment	Maximum 50% of total investment	Minimum US \$2.1 million
Over US \$10 million - US \$30 million	At least 40% of total investment	Maximum 60% of total investment	Minimum US \$5 million
Over US \$30 million	At least 1/3 of total investment	Maximum 2/3 of total investment	Minimum US \$12 million

Company Name

In China, the official legal company name is the Chinese name and will be registered with all major Chinese governmental authorities. The Chinese legal name has to follow the following legal format:

1. Company's chosen name (i.e., Moore);
2. Major business activity the company will perform (i.e., Consulting, Trading, Technology etc.);
3. Region or place of incorporation (i.e., Shanghai);
4. Legal structure of the company (i.e., Company Limited or LLC).

In addition to the Chinese name, companies can also choose an unofficial English name. The English name will be registered with the Ministry of Finance and Commerce (MOFCOM), may be represented on the company chop and can be used when registering with the bank.

Use of certain special names, such as those including 'China', 'State' or 'International', is only permitted if the company meets specific minimum registered capital requirements.



CHANGING COMPANY STRUCTURES

Any time after a Chinese subsidiary is established, the management of the company may have various reasons to change aspects or structural details of the company's registration. Common changes to the company structure include:

Change in Registered Personnel

Change in Business Scope

Change in Registered Address

Increase/decrease in Registered Capital

Change in Company Name

Changes to the Shareholder Structure

Whereas some of the abovementioned changes are characterized by a higher degree of complexity, the procedures for a change in the company structure generally includes the following steps:

- ▶ Preparation of relevant documents:
 - AMR application form(s), amendment of the Articles of Association and board/ shareholder decision;
 - Certain changes require the shareholder to prepare and obtain legalized company documents from the headquarters abroad;
- ▶ Update the company's record with the local AMR;
- ▶ Update the company's records with the Tax Authority;
- ▶ Update the company's record with its bank(s);
- ▶ Update company records at the Customer Authority (if applicable).

It is important that the management of a company is well aware of the time consuming and complex nature of some of the aforementioned changes prior to their initiation. In the section below, we highlight several key considerations with regards to common changes to the structure of a Chinese subsidiary.

A change in Registered Personnel

Whereas the change of General Manager, Supervisor and replacement/removal of a (Non-executive) Director generally requires a board/shareholder decision and an appointment/removal letter (with a potential alteration to the company's AoA), a change in the company's Legal Representative or Authorized Representative is more complex.

Changing of a company's Authorized Representative additionally requires the preparation of legalized company documents from the shareholder(s). On the other hand, in order to complete the change of a Legal Representative with the bank, it may be required for the newly appointed Legal Representative to make an in-person visit to the bank.

A change in Business Scope

As mentioned before, it is important that an alteration to the company's business scope is in line with the Negative List for foreign investment and follows the logic of the Catalogue of available business activities. If the company intends to extend its business scope to include "manufacturing" activities, it will be required to perform an Environmental Impact Assessment (EPA). Furthermore, if the company's updated business scope diverges significantly from the original, the company may be required to update the company's name accordingly.

Company Relocation/Change of Registered Address

Although a relocation within the same tax district is relatively straightforward, cross-district relocations remain significantly complex and may require several months to complete which can seriously affect a company's operations. The major challenge to cross-district relocations arises due to the required move of tax registration status, which includes a tax deregistration in the former tax district and registration in the new tax district.

In addition, when a company that engages in "manufacturing" activities relocates, regardless of whether this is within the same tax district, it must again complete an Environmental Impact Assessment (EPA) which increases the total time required for the administrative procedures.

An increase/decrease in Registered Capital

In addition to the aforementioned changes, a change in the company's registered capital will require the company to apply to the State Administration of Foreign Exchange (SAFE) for an update of its foreign exchange registration as well as the submission of a report to the foreign investment reporting system.

For a decrease of capital, the company must provide potential creditors the right to register any claims. Therefore, it must announce the intent to decrease the company's capital via a newspaper announcement and provide creditors 45 days to register any claims before proceeding with the application at the AMR.

A change in Company Name

Prior to preparing the application for the change of the Chinese company name, the company must submit several new options for the company name via the AMR declaration platform to confirm availability and validity of the proposed names.

After the change of company name has been successfully processed by the AMR and the new business license has been issued, the company must proceed to update all relevant materials displaying the Chinese company name (including but not limited to company chops).

Changes to the Shareholder Structure

These changes could include the revision of the shareholder structure as a consequence of an equity transfer or can include alterations to the shareholder's information, such as a shareholder's name.

In case of an equity transfer, an equity transfer agreement in compliance with Chinese law between the transferor and the transferee should be made. Additionally, legalized company documents from the new shareholder must be provided for verification of its qualifications. If a capital gain arises, the Chinese subsidiary must withhold the relevant capital gains tax, on behalf of the shareholder.

COMPANY LIQUIDATION

Foreign investors may have a wide variety of reasons why their Chinese subsidiary is no longer within the best interest of the firm. However, when the company does decide to close its Chinese operations, it is essential to follow the proper procedures to liquidate the company. Failure to do so can severely negatively affect the company's future reputation in- and ability to do business with China, resulting in stringent fines or penalties by the Chinese authorities and can cause blacklisting for its registered personnel, possibly banning them from entering or leaving China. Properly liquidating the company can be a time-consuming process, which can easily take up to 1 year or more.

Below we provide an overview of the reasons to liquidate a company, the consequences of not complying, a high level overview of the important factors to consider when deciding to liquidate a Chinese subsidiary and an outline of the essential steps in the liquidation process.

Reasons to liquidate a company

According to the Company Law of the People's Republic of China there are five reasons as to which a company can be liquidated:

- ▶ When the business term as specified on the business license and in the Articles of Association expires;
- ▶ If the board of shareholders or general meeting decides to dissolve the company;
- ▶ If dissolution is necessary as a result of the merger or division of the company;
- ▶ If the company's business license has been revoked, or it is ordered to close down or to be revoked according to the law; or
- ▶ It is ordered to be dissolved by the people's court.

Consequences of not complying with the proper deregistration procedures

If the company does not complete the deregistration procedures or fails to pay taxes, its employees or major creditors, the company and its registered personnel may face among others the following legal consequences:

- ▶ The company can incur heavy fines and penalties from the tax bureau;
- ▶ The Legal Representative may be subject to personal liability;
- ▶ The Legal Representative may not be permitted to act as Director, Manager or Supervisor of a Chinese company for a period of three years;
- ▶ The shareholder of the company will not be permitted to invest in another Chinese company for a period of three years;
- ▶ The company may not be able to re-register its name for a period of three years;
- ▶ The registered personnel may be denied entry into China.



CONSIDERATIONS WHEN LIQUIDATING

To be able to fulfil all requirements in the liquidation process and to obtain approval to deregister the Chinese entity, several important aspects should be considered prior to the liquidation procedures:



Termination of labor contracts

The Chinese labor law is protective of employees and as such the company must reach a settlement with each individual employee. If the company intends to fire in excess of 20 employees, it must report its intention to do so to the local labor bureau 30 days prior to the official decision.



Ongoing legal disputes

As per Chinese law and regulation, all legal disputes or ongoing legal cases must be settled before a company can be liquidated. If serious legal disputes arise during the liquidation procedure, the liquidation processes will be halted until the dispute is resolved.



Annual Statutory Requirements

Until the official deregistration of the entity is completed, any foreign-invested enterprise in China must continue to complete the annual statutory requirements, including:

- A Year-end statutory audit (performed by a qualified CPA).
- The Annual Corporate Income Tax Filing.
- An Annual Publication Report



Registered address

During the liquidation process, meaning until the business license is retracted, a company needs to have a valid registered address.



LIQUIDATION PROCESS: ESSENTIAL STEPS

Once the decision or order has been made to dissolve a company, a lengthy administrative process starts in order to completely liquidate the company. Below we highlight the necessary steps that must be taken to complete the liquidation of a Chinese subsidiary.

1. Set up Liquidation Committee

Within 15 days of the decision to liquidate a company, a Liquidation Committee must be formed. This Committee examines the company's assets, prepares a balance sheet and notifies creditors by announcement.

2. Selling the assets of the WFOE

The receipts of the sales will be used to settle outstanding costs and debts, incl. 1) liquidation expenses 2) outstanding employee salaries, social insurance fees and severance fees 3) outstanding tax liabilities 4) other outstanding debts. Any funds remaining after settling of debts and costs can be distributed back to the shareholders.

3. Registration of the liquidation with the AMR

The Committee needs to notify the State Administration of Market Regulation about the liquidation.

4. Newspaper announcement

Within 60 days after the establishment of the Liquidation Committee, the company must make a newspaper announcement of the liquidation in order to notify all creditors. This announcement provides creditors a period of 45 days to declare any claims to the Liquidation Committee.

5. Creditors register their claims

During the declaration period the creditors can submit a statement to the Liquidation Committee regarding their claims, pledges to the claims and evidence of these claims.

6. Settlement of debt with creditors

Once all creditors and their claims have been identified, the Liquidation Committee can make the necessary arrangements to settle the debts of the company.

7. Registration of the liquidation with the MOFCOM

Next to registering the liquidation with the AMR, the company also needs to submit the shareholder resolution (stating the intent to liquidate the business) to the Ministry of Finance and Commerce (MOFCOM).

8. Liquidation approval by Tax Authority

One of the most difficult and time-consuming procedures in the liquidation process is to obtain the approval from the Tax Authority. Since the liquidation of a company means the loss of tax revenue for the local district tax bureau, the tax office in charge generally causes a delay in the liquidation process.

9. Deregistration at Customs Bureau

Before the company can be officially deregistered, the existing customs license (if applicable) must be cancelled.

10. Cancellation of company specific licenses

If the company is in possession of industry or company specific licenses such as a food & beverage license or an alcohol license, these must be cancelled before the company can officially be deregistered by the AMR.

11. Liquidation of company with AMR

Upon handling the deregistration at the tax office and cancellation of company specific licenses, the company can initiate the formal liquidation application with the AMR. The company has to supply the following documents:

- ▶ Application for cancellation of company registration.
- ▶ Resolution of the shareholders meeting.
- ▶ Liquidation report.
- ▶ Tax clearance certificate.

12. Deregistration at other relevant authorities

Once the company receives a receipt confirming the liquidation and can use this receipt to handle the deregistration at any remaining authorities. Companies are required to deregister at the following institutions:

- ▶ Social Security Bureau.
- ▶ State Administration of Foreign Exchange.

13. Closing bank accounts

Since it is not possible to close a bank account when there are still funds in it (or interest built up), the remaining funds on the account must be spent or withdrawn prior to closure of the company's bank accounts.

14. Disposal of company chops

After all the aforementioned deregistration procedures are completed, the company chops have to be destroyed. Please note it is important to delay this step until other procedures are finalized, as the chops may be required for the preceding procedures.

Bankruptcy

The main difference between a liquidation procedure and a bankruptcy procedure is a loss of control over the entity.

In case of a bankruptcy procedure, a bankruptcy committee will be established. Similar to a liquidation committee, the bankruptcy committee is responsible to carry out the deregistration of the company – meaning it is their responsibility among others to sell the company assets, settle outstanding debt with creditors and reach settlement with employees (if not done already).

Although a member of the shareholders will be part of the bankruptcy committee, the remainder of the committee will be appointed by the Chinese court. Please note that the company will have no decision-making authority over whom will be appointed, and the company will be responsible to pay these professionals that are appointed for their services.

Because these committee members are mandated by the Chinese authorities, the committee members may not regard the company's interest as their highest priority and therefore the company would experience a loss of control over procedures such as the sale of assets as well as negotiation and settlement with debtors.

A bankruptcy procedure is generally not initiated by the company, but rather by an external debtor. Therefore, it is crucial to ascertain whether it is expected that the company is able to repay its debt and reach settlement with its employees prior to initiating a liquidation procedure. By doing so the company can determine whether the benefits of a controlled liquidation, which may require the company to bring in additional funds, outweigh the risks associated with a bankruptcy procedure and its potential consequences for the company's reputation.

DORMANCY STATUS

There are many reasons why a foreign-invested company may decide to suspend their business activities in China. However, if a company decides to continue to have a legal entity in China and not to liquidate these, it will be required to satisfy several ongoing compliance requirements as described in the remaining chapters of this guide. In order to mitigate costs there are two options available, namely (1) decreasing activities and costs to the lowest possible level, while continuing to satisfy all regular compliance requirements or (2) to use the new 'business suspension policy' (in other words, a company dormancy status) introduced in 2022.

Under normal circumstances, if a company neglects its compliance requirements for more than 6 months, the company's business license can be revoked. However, if a company applies for official dormancy status as per the new regulations, the Chinese subsidiary will retain its business license and all its qualifications.

The following are the compliance requirements which an officially dormant company in China must meet (as opposed to an operational company):

- **Company address:** a dormant company may use an address solely for service of legal documents (instead requiring an actual physical registered address for operational companies) reducing costs significantly;
- **Staff considerations:** whereas it is theoretically possible to retain staff during the dormancy period, the company would still be required to make social security contributions, which may be challenging during the dormancy state with less funding available;
- **Tax and reporting requirements:** according to the implementation guidelines, dormant companies are still required to publish their annual reports. The national regulations do not specify however whether dormant companies continue to have to comply with other tax and reporting requirements, similarly as operational companies.

Companies can retain a dormant company status for a period of up to 3 years, after which the company will automatically resume operations unless a decision to liquidate has been made or an extension has been filed for. In addition, there are limited conditions under which a Chinese subsidiary can apply for dormancy status, including difficulties operating due to natural disasters, accident disasters, public health incidents and social security incidents.





COMPLIANCE



Managing compliance relates to all the efforts a company makes to exert control and address negative impacts that may arise from internal operations. While doing business in China, foreign-invested enterprises should understand the importance of remaining compliant with Chinese legislation. Successful compliance management does not only minimize risk of non-compliance but will also help create trust between consumers and companies by fostering market integrity. Particularly in light of the implementation of the Chinese Corporate Social Credit System, compliance is more important than ever.

Once a foreign investor has legally established a subsidiary in China and obtained its business license it is required to complete several administrative and compliance requirements on a monthly, quarterly, and annual basis. In particular, foreign-invested enterprises are required to maintain a reliable record of accounts, must submit tax filings (for Corporate Income Tax (CIT), Value Added Tax (VAT), Individual Income Tax (IIT) and Surtaxes among others), and contribute to social security insurances and the housing provident fund.

This chapter provides a generic overview of the aforementioned compliance requirements for foreign-invested enterprises in China, with more detail provided in subsequent chapters. This chapter also discusses several administrative and key internal control processes which must be considered for successful and compliant Chinese operations.

Annual Compliance Requirements

According to Chinese law, all foreign-invested enterprises in China must undergo several annual statutory requirements, which can be divided into the following types:

- ▶ A year-end statutory audit (by a qualified CPA);
- ▶ An annual Corporate Income Tax Filing;
- ▶ Publishing of the annual publication report.

For more detailed information on China's annual compliance requirements please see section 4 Accounting and Annual Auditing.

Summary of Chinese Compliance Requirements

Category	Requirements	Deadline
Accounting	Maintain reliable record of accounts and submission of Balance Sheet and Income Statement	Monthly filing (15th of following month)
CIT	Provisional filing for Small- and Medium sized Enterprises	Quarterly provisional filing (15th of next subsequent month following the quarter)
	Provisional filing for Large enterprises	Monthly provisional filing (15th of next subsequent month)
	Annual CIT Filing	Before May 31st of subsequent fiscal year
VAT & Surtaxes	Small-scale Taxpayers	Quarterly filing (15th of next subsequent month following the quarter)
	General VAT Taxpayers	Monthly filing (15th of next subsequent month)
IIT	All companies employing individuals act as withholding agent	Monthly filing (15th of next subsequent month)
Social Security & Housing Fund	All companies employing (Chinese) individuals	Monthly filing (10th of next subsequent month)
Audit	All foreign-invested enterprises	Annually, prior to annual CIT filing deadline
Publication Report	All foreign-invested enterprises	Before June 30th of subsequent fiscal year

RECURRING COMPLIANCE REQUIREMENTS

Any foreign-invested enterprise in China is required to commence with basic tax registrations, and consequently must complete administrative and tax compliance requirements, within 30 days of issuance of the business license for the Chinese subsidiary. The compliance requirements can be divided in those which must be completed on a monthly, quarterly and annual basis.

Monthly Compliance Requirements

All companies in China must maintain a reliable record of accounts in line with the Chinese Accounting Standards (CAS), also known as the Chinese Generally Accepted Accounting Principles (PRC GAAP). These companies must submit their Balance Sheet and Income Statement to the relevant tax authority when completing monthly tax filings (see section 4 for a complete overview of accounting requirements in China).

Companies which are registered as a General VAT Taxpayer must complete monthly VAT and Surtax tax filing. Furthermore, companies employing individuals are required to withhold IIT on behalf of their employees on a monthly basis. Finally, large enterprises may choose to complete monthly CIT filing on a provisional basis instead of quarterly basis. The monthly tax filing deadline for the aforementioned taxes for companies in China is the 15th day of the subsequent month (i.e., the tax filing deadline for the month of February is March 15th). Please note that due to public holidays the monthly tax deadline may be altered pending a notification from the tax authorities.

Those companies employing individuals must also make contributions to social security insurances and the housing provident fund (for local employees) every month. In general, contributions for these social securities must be declared and paid before the 10th day of the subsequent month, but this can differ by region.

Please note that the Chinese taxation system is administered at a local level, and as a result, relevant tax filing deadlines may differ per locality and are subject to notice from the relevant tax authorities.

Quarterly Compliance Requirements

Although Small-scale Taxpayers may elect to complete VAT filings on a monthly basis, they are legally required to complete filing for VAT and Surtaxes on a quarterly basis. Moreover, SMEs in China are required to complete CIT filings on a quarterly basis. The quarterly tax filing deadline occurs on the 15th of the subsequent month, following the end of the quarter (i.e. the tax filing deadline for Q1 is April 15th).



FAPIAO MANAGEMENT

As discussed in the previous section, taxpayers in China must declare VAT on monthly or quarterly basis. Since VAT filing in China is closely linked to the fapiao system (Chinese invoicing system) it is imperative for foreign-invested enterprises to understand what is a fapiao and how it is used.

The literal translation of the word fapiao (发票) is “invoice” and it plays an essential role in China’s invoicing system. In China, companies must record all business transactions on a fapiao, which serves as both the legal receipt and tax invoice. Its importance is derived from the fact that it serves the following purposes:

1. **Obtaining a fapiao is legally required to recognize costs as an expense on an accounting level.**
2. **The issuance of a fapiao determines when VAT is due.**
3. **The Chinese authorities use fapiaos to track transactions for tax purposes and to prevent tax evasion.**

The local State Administration of Taxation (STA) oversees the printing, distribution and administration of fapiao(s) in China. Taxpayers must obtain the fapiao by purchasing them from the tax office according to their actual business needs and must (in) print the fapiao using a special government issued printer. The printer is linked to the tax system and via a company specific USB-stick which must be inserted into the printer so the taxpayer is identified. Due to the direct link between the company and tax system, a transaction is recorded in the records of the tax bureau and VAT is due upon printing a fapiao (payable by the tax filing deadline in the next subsequent month).

The Chinese invoicing system recognizes two types of fapiao(s):

► General VAT Fapiao

The general VAT fapiao cannot be used to deduct input VAT for tax purposes. As such, they are generally used by small-scale taxpayers.

► Special VAT Fapiao

Special VAT fapiao provides the right to input VAT deduction and are generally used by General VAT Taxpayers (except those taxpayers selling specific consumer goods such as cigarettes, alcohol, cosmetics etc.).

E-Fapiaos

In recent years the authorities have also started implementing a digital version of the fapiao, called e-fapiao. The digital version allows for a faster, more convenient way for vendors to issue a fapiao. The e-fapiao has the same validity as the paper version.

COMPANY CHOPS & KEY DOCUMENTS

In addition to the aforementioned compliance requirements set out in Chinese law, it is essential for foreign investors to retain control over their Chinese subsidiary and avoid any potential legal, financial or operational risk to their China operations. Therefore, in this section we discuss the importance of company chops in China as well as essential company documents which companies must maintain.

Company Chops

To validate any document within China needed to conduct business, the official company chop of the company is required. These chops are special government issued seals (or stamps), which all business entities in China have and are of the utmost importance to the company. Even though signatures can be used to validate documents on behalf of individuals, only the stamping of a document with the relevant chop makes the document truly legally binding for a company.

Because a company chop is the legal evidence of a company’s activities, it holds extraordinary power to legally bind a company. It is essential to use internal control processes to regulate and record the usage of the company chops to avoid misappropriation or misuse. Another option for foreign investors is to entrust usage of company chops to a trusted third-party service provider whom acts only on behalf of the company upon specific confirmation from an appointed authorized representative of the shareholder.

A Chinese subsidiary generally has the following types of company chops:

► **Company chop:**

The company chop is the most important seal for any company in China and is issued by the relevant Chinese authorities. The company chop represents a company's official decision and is applied to any official letters provided by the company, any supporting documents for relevant authorities, and is used to sign contracts and issue official reports to the public.

It is important that the company chop is exclusively safeguarded by the legal representative. Once the company chop is used on any document, it implies that the company has confirmed or agreed upon the activities, as well as acceptance and awareness of any subsequent risks or consequences attached to those activities. If a document is chopped the company shall bear all (legal) responsibilities of using the company chop.

► **Finance chop:**

Every company must have a finance chop and this chop is used for handling any affairs or documents related to financing (e.g. opening a bank account, authenticating financial documents, issuing checks or performing bank related transactions). It is advisable to keep the company and finance chop segregated to avoid misuse.

► **Legal representative chop:**

The legal representative chop is held by the company's legal representative and represents the signature of the legal representative in its absence. Because the legal representative has the authority to enter into binding obligations on behalf of the company, when used solely or along with the company chop, it represents an official company decision. This chop is commonly used to issue cheques, approve payment transactions or used to sign contracts.

► **Invoice chop:**

The invoice chop is mandatory in order to issue official Chinese invoices or tax receipts (called fapiao – see section 3 on Compliance for more information on fapiaos).

► **Custom chop:**

The customs chop is used for import or export related business activities and therefore is generally kept by the employee(s) in charge of managing import and export related affairs. Without this chop, the company will be unable to process any imports or exports.

► **Contract chop:**

Many companies use a separate chop for signing contracts between parties (such as the company and its employees, or the company and a third-party, such as a client). This specific chop can represent the company within the scope of the contract and shall bear all rights and obligations therefrom. As this chop grants the person responsible less authority than the company chop, it is generally useful for delegating authority.

Electronic Chops

Similar to the use of electronic business licenses and e-fapiaos, the authorities are also working on the implementation of digital company chops, or e-chops. Electronic chops carry the same legal status as physical chops and can be used for online transactions and in some regions it can also be used for signing government or bank documents.



Company Legal Documents

Every company in China is required to maintain several essential documents. Additionally, in order for companies to fully operate within the limits of their business scope they may be required to obtain additional approvals, certificates or licenses from specific government authorities.

Below we provide an overview of essential company documents:

▶ The Business license:

The company business license is one of the most important company documents in China and its issuance marks the existence of the legal structure of the company. As of October 2016, with the aim to simplify administrative procedures, companies receive the so-called “Five-in-One” business license which integrates the following applications:

- i. The original business license;
- ii. The organization code certificate;
- iii. The tax registration code certificate;
- iv. The social security registration certificate;
- v. The statistics registration certificate.

▶ Bank Account Opening Permit:

The bank account opening permit serves as proof that the company has opened an RMB Basic Account. This permit is (among others) presented to the tax authorities to link the company's bank account with the company's tax registrations, in order to withhold taxes accordingly.

▶ FDI Registration License:

The FDI registration certificate is issued upon application with the Chinese State Administration of Foreign Exchange and grants the company the right to open a foreign currency capital account and engage in current account transactions which require the exchange of RMB and foreign currency.

▶ Foreign Trader Registration Certificate:

The foreign trader registration certificate grants the company the right to engage in the import or export of goods.

▶ Other optional licenses:

In addition, companies may need to obtain additional industry specific licenses such as a Food & Beverage License, Alcohol License, Accounting License etc.

BANK ACCOUNT MANAGEMENT

Another area of compliance, financial and operational risk for a foreign-invested enterprise in China is banking. Firstly, in terms of compliance it should be known that the Chinese authorities retain a high level of control over the foreign exchange market and cross-border capital flows. In China, the banks are responsible to review all current account transactions involving foreign exchange on behalf of the State Administration of Foreign Exchange (SAFE), which is the regulatory body responsible for governing and oversight of China's foreign exchange of RMB. As a result, Chinese subsidiaries of foreign-invested enterprises that wish to engage in any transactions which involve foreign exchange will be required to meet administrative and procedural requirements as set out by their (local) bank (see section 9) for more information on China's foreign exchange market).

It is essential for the shareholders of a Chinese subsidiary to have access to and control over their bank accounts in China. As such, it is imperative for foreign investors to choose a bank that can appropriately support their operational needs and provide a transparent overview of the company's accounting. Although most major Chinese banks provide English language services it should be noted that the Chinese banking system is coordinated centrally by the People's Bank of China (PBOC) and as a result, all details of a domestic transaction in RMB should be provided in Chinese language. As such, it may be useful to outsource the administrative banking procedures to a trusted third-party service provider. In addition, Chinese banks generally use bank tokens (USB-sticks) for preparation and approval of payments and it is advisable to maintain a separation of these powers in different tokens (i.e. the approval token is kept only by a representative of the shareholder).

CORPORATE SOCIAL CREDIT SYSTEM

China's Social Credit System is designed to regulate the behavior of both individuals and businesses active in the Chinese market with incentive and punishment schemes, with the aim to increase compliance with Chinese law and regulations. As such, the overall aim of the Corporate Social Credit System is to create a self-regulating market.

The system rates both Chinese and foreign companies and will have far reaching consequences. Companies will be classified on a scale ranging from excellent to poor, affecting the way to do business. Where an excellent rating can yield rewards, a poor rating can severely hamper day-to-day business.

With full implementation of the system expected in 2021, it is essential for all companies to understand how the system works and prepare their business to fulfill all requirements to receive a good rating, or at the very least, avoid a bad rating or non-compliance record.



ACCOUNTING & ANNUAL AUDIT



An important aspect for foreign-invested enterprises in China who wish to ensure compliance is the performance of accounting and annual audit in line with Chinese requirements. This is often a challenge for foreign companies as China has implemented its own rules and regulations. Key issues for foreign entities include understanding China's accounting standards and completing the accounting and auditing in Chinese.

In this section we enumerate upon the requirements for Chinese subsidiaries as per the Chinese Accounting Standards, including accounting requirements as well as requirements regarding annual audit.



CHINESE ACCOUNTING STANDARDS

When preparing the financial reports of a Chinese subsidiary, foreign-invested enterprises are required to follow the Chinese Accounting Standards (CAS), also commonly known as the Chinese Generally Accepted Accounting Principles (or PRC GAAP).

The Chinese Accounting Standards consist out of two standards:

- ▶ The Accounting Standards for Business Enterprises (ASBEs);
- ▶ The Accounting Standards for Small Business Enterprises (ASSBEs).

The majority of foreign-invested enterprises will adopt the Accounting Standards for Business Enterprises (ASBEs) as they maintain a high level of integration with international accounting standards such as IFRS and US GAAP.

On the other hand, the Accounting Standards for Small Business Enterprises (ASSBEs) can be adopted by small-scale enterprises instead of the Accounting Standards for Business Enterprises (ASBEs), and therefore fulfill a similar role as compared to the IFRS for SMEs. Whereas the ASBEs form the basis for the ASSBEs, the ASSBEs are more in line with Chinese tax law which results in a simplified process for adjustments during the annual CIT filing due to discrepancies between Chinese accounting standards and Chinese tax law.

It should be noted that there are a number of limitations of the Accounting Standards for Small Business Enterprises in China as opposed to the regular accounting standards, namely the ASSBEs do not allow for amortization and do not allow for the depreciation of accounts receivable (AR) and inventory (note that the depreciation of fixed assets remains possible within the framework of the ASSBEs).

Essential Rules within the Chinese Accounting Standards

The Chinese Accounting Standards stipulate a number of essential rules for the preparation of a company's financial statements. The purpose of the Chinese Accounting regulations is to ensure the accounting truthfully reflects the financial situation and operating results of an enterprise, as the Chinese Accounting Standards are used to determine applicable taxes and distributable profit. For this reason, the Chinese Accounting Standards stipulate that accounting should be done on an accrual basis for for-profit enterprises. Cash-based accounting on the other hand is applicable to administrative/public institutions and to Representative Offices (ROs).

The financial statements of a Chinese subsidiary have to be prepared on a monthly basis and must be submitted to the Chinese authorities by the monthly tax filing deadline, generally the 15th of the subsequent month. The financial statements which must be prepared include:



Although foreign-invested enterprises can use other currencies than RMB for business transactions, it is required for the financial reports to be in Chinese and the RMB is the base currency for the ledgers and financial reports. As such, foreign-invested enterprises may choose to apply either Chinese or a combination of Chinese and another foreign language for their accounting records.

In accordance with Chinese law, the fiscal year in China must start on January 1st and end by December 31st, with no exceptions. Furthermore, the accounting records and supporting documents of a Chinese company must be retained for a period of 10 years. This also means that companies are required to keep a physical record of supporting documents such as fapiao (official Chinese invoices) for this duration.

CHINESE ACCOUNTING STANDARDS VS IFRS

Since the main objective of the Chinese authorities to issue the ASBEs and ASSBEs was further convergence with internationally accepted accounting standards, the Chinese Accounting Standards maintain a high level of integration with IFRS. Despite substantial convergence, a number of key differences between Chinese GAAP and IFRS still exist:

- ▶ **Fixed Asset Valuation Method:** according to the Chinese accounting standards companies can only use the historical cost method to value fixed and intangible assets. The historical cost method does not allow for re-evaluation of assets and thus may result in impairment losses of long-term assets.
- ▶ **Fiscal Year:** as mentioned before, the Chinese fiscal year always runs from January 1st until December 31st without exceptions.
- ▶ **Tax Filing:** whereas IFRS may permit returns to be filed on a quarterly or bi-monthly basis, the Chinese Accounting Standards stipulate submission of financial statements on a monthly basis.
- ▶ **Classification of Expenses:** the Chinese Accounting Standards stipulate that expenses are classified according to function, whereas IFRS would classify said expenses by nature.

Despite the substantial convergence between the Chinese Accounting Standards and IFRS, foreign-invested enterprises in China must be aware of key differences, as this can impact financial control over its Chinese subsidiary. It is common in China for issues to be uncovered in the accounting records of a subsidiary, such as having multiple sets of financial statements or revenue being received off the books, resulting in the misinterpretation of the company's financial situation, and therefore it is essential to institute proper policies and rely on the advice of a third-party service provider where required for a complete understanding of Chinese regulations and its impact.

ERP SYSTEMS AND DATA STORAGE

A key item in ensuring your entity in China remains compliant, while also keeping control over the entity with transparent information, is your company's ERP (Enterprise Resource Planning) system. After setting up an entity in China, it is an essential decision which ERP system will be used for the Chinese entity. Whether you will integrate the Chinese subsidiary into the headquarter system or use a different local solution, will affect the availability and accuracy of the data available.

ERP systems in China

In China there are strong domestic companies offering ERP solutions, as well as large international players. There are three main large domestic companies offering ERP software; Yongyou, Kingdee and Inspur. In 2020 these three had a combined market share of around 57%. However, their market share is mainly fueled by the wide adaptation by SMEs. In the high-end ERP market the combined market share for Kingdee and Inspur is only 20%. In the high-end ERP market international ERP systems are more dominant, with SAP and Oracle representing a 53% market share.

The largest players in the worldwide ERP market such as SAP, Oracle and Microsoft all do offer their ERP solution in China as well, although sometimes they are serviced from Hong Kong. Additionally, nowadays many companies use cloud platforms such as QuickBooks or Sage. Even though the software can work in China, these companies do not have domestic entities and as such can not provide data storage in China, which can cause issues with respect to the data storage requirements, which we discuss below.

Data storage requirements

With the increasing use of cloud software for accounting, many international companies use the same software around the world. Generally, headquarters prefer their subsidiaries to perform the accounting in the system provided by the headquarters, to make consolidation at the group level easier. However, the Chinese authorities have strict requirements on the local storage of data. Nevertheless, to facilitate the use of cloud accounting software, the Ministry of Finance issued the "Standards for Enterprise Accounting Informationization" (Caikuai (2013) No. 20).

According to article 36 of this announcement, the deployment of the data server of the enterprise accounting information system must comply with relevant national regulations. If the data server is deployed overseas, a backup of the accounting information must be kept in the country, and the backup frequency must be no less than once a month. The accounting data backed up in China should be able to independently meet the needs of the enterprise to carry out accounting work and the needs of external accounting supervision when the overseas server cannot work normally.

Additionally, for local auditors it can be difficult to review accounting data in overseas software, so a local copy of the accounting data in a local system such as Kingdee or Yongyou is advised to facilitate the audit. In general, it is possible to run two types of accounting, one locally in a local system to satisfy local regulations and facilitate the statutory audit, and a second accounting book in the headquarters' system.

ANNUAL AUDIT IN CHINA

According to Chinese law, all foreign-invested enterprises must undergo several annual statutory requirements, notably including an annual audit, annual CIT filing and annual publication report. All Chinese subsidiaries regardless of legal form, being WFOE, Joint Venture or Representative office, have to complete the aforementioned annual statutory requirements.

1. Annual Audit Report

Since foreign-invested enterprises are required to disclose whether they have performed an annual audit to the annual reporting and serves to ensure that a foreign-invested enterprise has met the Chinese Accounting Standards (PRC GAAP), the annual report is the first step of the annual statutory requirements.

The annual audit has to be performed by a Chinese-registered Certified Public Accountant (CPA) firm and signed by two registered CPAs. For performance of the annual audit we regularly cooperate with our China CPA firm within the Moore Network, Moore Da Hua CPA. The annual audit report generally consists out of a balance sheet, an income statement, a cash flow statement, a statement of change in equity and supplementary statement. It should be noted that the requirements for the annual report vary per locality in China and therefore it is advised that foreign investors review the applicable local rules dictate on the contents of the annual audit report and to which rules to conform.

The formal annual audit report must be performed in Chinese, but it is recommended to obtain translation thereof for group reporting purposes. In addition, foreign investors may request an accountancy firm or foreign CPA to provide support during the annual audit procedures in addition to the required Chinese CPA firm.

It is estimated that the performance of an audit would take approximately two months under normal circumstances. It is further advisable to complete the annual audit report no later than the end of April, to ensure the Chinese subsidiary has ample time to perform the annual CIT filing.

2. Annual CIT Filing

The Chinese Corporate Income Tax (CIT) rate is 25% (where preferential rates are applicable to SMEs) and CIT is declared and paid on a monthly or quarterly basis. Due to discrepancies between the Chinese Accounting Standards and the Chinese tax legislation, there may be differences between CIT taxable income and as a result between CIT paid throughout the year and actual CIT due.

As such, the Chinese State Administration for Taxation requires all companies to perform an annual CIT reconciliation filing to determine if all tax liabilities have been met. Consequentially, in case of deficient payment or overpayment, companies can apply for a refund or must pay supplementary tax.

The annual CIT reconciliation filing must include adjustment sheets concerning the detailing the aforementioned discrepancies between Chinese Accounting Standards and Chinese tax law as well as a supplementary report concerning transactions with related parties. Special rules apply to companies who operate branch offices in several locations and are required to pay tax on a consolidated basis.

Foreign investors should bear in mind that the deadline for the annual CIT reconciliation filing is May 1st of the subsequent fiscal year, and companies may be requested to provide additional documents by the authorities which can extend the annual compliance processes. Penalties are imposed on those companies that fail to abide by the deadlines as prescribed by the in-charge authorities. In case companies are unable to meet the stipulated deadline in the event of force majeure the deadline can be extended, for which the company must apply and receive approval.

It is anticipated that the local in-charge tax authorities will issue further guidance with respect to the year's annual CIT reconciliation filing around March and foreign investors are advised to review these or request support from a qualified third-party service provider.

3. Annual Publication Report

Once the annual audit report has been completed and the annual CIT reconciliation filing has been performed, foreign-invested entities will need to what is referred to as the “many-in-one” annual reporting or the annual publication report to several government authorities. As of the implementation of the Foreign Investment Law (in 2020) the annual report to the local Administration for Market Regulation (AMR) and the annual combinative reporting have been combined into one and shall be submitted through the National Credit Information Publicity system.

It should be noted that depending on the business scope of the company as well as the city and district in which it is located may cause differences in the documents required in the annual publication report.

Foreign-invested enterprises are required to prepare and submit the information in the annual publication report by June 30th of the subsequent fiscal year. If companies fail to submit the annual publication report timely they will be noted on the Catalogue of Enterprises with irregular Operations which is publicly accessible. Non-compliance with annual publication report deadlines and requirements for several years may cause blacklisting and significantly impact future operations.



TAXATION



All companies in China are required to meet their tax obligations and complete monthly tax filings as set out in Chinese tax legislation. The objective of compliance with Chinese tax legislation is to maintain control over the operations of the subsidiary and minimize risk associated with non-compliance.

There are two main types of tax that can apply to companies in China. The first type is taxes which are related to the company's income and profit (direct taxes): Corporate Income Tax (CIT) and Withholding Tax. The second type is related to sales and turnover (indirect taxes): VAT, Consumption tax, stamp tax and real estate tax. Additionally, individuals (and companies) are also impacted by Individual Income Tax (IIT) and other payroll taxation such as social security contributions.

In this chapter we discuss how tax regulations are implemented and regulated and go into detail on the most important taxes applicable to companies operating in China.

DIRECT TAXES/TAX ON INCOME

Corporate Income Tax

Corporate income tax is generally levied against a company's net income after a deduction of reasonable business costs and losses in a financial year. In China, corporate income tax can either be settled quarterly or annually, with adjustments being refunded or carried forward to the following financial year. All reasonable business costs and losses incurred during this fiscal year must be deducted of the total annual income in order to derive a company's taxable income. In order to determine the applicable tax rate, we must review a company's net profits.

Corporate taxpayers in China

When applying Corporate Income Tax regulations, companies are classified as resident enterprises and non-resident enterprises. Resident enterprises include both enterprises established in China in accordance with Chinese law and enterprises established in accordance with foreign law, but which are actually under the administration of institutions in China. Non-resident enterprises are enterprises which are set up in accordance with the law of a foreign country or region and whose actual administrative institution is not in China, but which have institutions or establishments in China, or which have no such institutions or establishments but have income generated from inside China. Both categories are subject to CIT, albeit with certain differences. Resident enterprises are taxable on their worldwide income while non-resident enterprises without establishment in China are only taxed on its income generated in China. Nonresident enterprises with establishment in China are taxable on the income derived from its related Chinese establishment.

CIT Rate and Calculation Method

China Corporate Income tax for both foreign- and domestic enterprises is levied on company profits at a rate of 25%. However, for non-resident enterprises without establishment in China that are taxed on their China-sourced income, the applicable CIT rate is 20%. Currently, there are also interim regulations in place for small and low profit companies to pay a lower percentage of CIT. According to these regulations, companies with a profit below RMB 1 million effectively pay 5% (was 2.5% from 1 January 2021 until 31 December 2022) CIT and companies with a profit between RMB 1 million and RMB 3 million effectively also pay 5% CIT from 1 January 2022 until 31 December 2024 (previously 10%)

The following formula for the calculation of CIT payable is applicable:

$$\text{CIT Payable} = \text{CIT Taxable Income} * \text{Applicable Tax rate} - \text{Tax Exemptions or Reductions (if applicable)}$$

Furthermore, CIT Taxable Income in China is determined according to the following formula:

$$\text{CIT Taxable Income} = \text{Total Annual Income} - \text{Expenses/Costs} - \text{Carry Forward Losses}$$

CIT is calculated on an accrual basis, meaning income and expenses are recorded at the time they are earned or spent. It is calculated and paid monthly or quarterly (within 15 days of the period end), and reconciled annually as part of a company's year-end audit. Here it is important to note that in China losses can be carried forward for a maximum of 5 years. Moreover, expenses can be deducted when companies can provide the relevant fapiao of the expense.

Filing and Payment of CIT

CIT must be filed and paid on quarterly basis. However, it is possible for large enterprises to file and pay CIT on a monthly basis, whereas this is not advisable for SMEs due to the additional administrative burden. Companies are required to submit their tax declarations for the pre-payment of CIT and pay advance taxes within 15 days after the end of each month or quarter (subject to change depending on Chinese national holidays). Annually, companies are required to settle and file annual Corporate Income Tax payments within five months after the end of the tax year (deadline of May 31st). Because of discrepancies between Chinese accounting standards and Chinese tax law, the actual amount of CIT taxable income may be different from the total profits based on the accounting standards.

CIT Exemptions/Reductions in China

There are certain statutory- and additional deductions available in line with Chinese law which could lower the CIT burden of a company. These deductions which are allowable for CIT generally include: Business costs and expenses incurred in relation to income received; appropriate taxes and losses; charitable donations; depreciation of fixed assets; amortization of intangible assets; and lastly any reductions based on local tax incentives.

Per 1 January 2023, the government has implemented increased pre-tax super deductions for R&D expenses. If the R&D expenses actually incurred in the R&D activities of the enterprise do not form intangible assets, and are included in the current profit and loss, 100% of the actual amount incurred can be additionally deducted before tax. If intangible assets are formed, they will be amortized before tax according to 200% of the cost of the intangible assets.

Other common CIT exemptions and reductions include:

-High tech enterprise are eligible for a reduced CIT rate of 15% after obtaining a high technology certificate.

-Companies active in encourage designated key software and integrated circuits design are eligible for an initial five year CIT exemption and subsequently to a reduced CIT rate of 10%.

-Companies located in specific regions, Free Trade Zones and Cooperation Zones may be eligible for a reduced CIT rate of 15% if their activities fall within the local catalogue for preferential treatment. Such areas include:

- Western Regions (Chongqing, Gansu, Guangxi, Guizhou, Inner Mongolia, Ningxia, Shaanxi, Sichuan, Qinghai, Tibet, Xinjiang, and Yunnan)
- Qianhai Shenzhen-Hong Kong Cooperation Zone
- Guangdong-Macao Intensive Cooperation Zone (Zhuhai)
- Pingtan Comprehensive Experimental Zone (Fujian)
- Hainan Free Trade Port
- Nansha District in Guangzhou
- Lingang New Area in Shanghai.

Withholding Taxes

Withholding tax is a Corporate Income Tax levied on non-resident enterprises without permanent establishments in China that generate China-sourced income. Withholding tax is especially of importance when looking at Chinese profit repatriation. There are several categories of China-sourced income, including:

- Dividend income derived from equity investments (e.g., foreign-invested enterprises (FIEs)).
- Royalty income (e.g., licensing a trademark).
- Interest income derived from the provision of funds.
- Other income that may be deemed taxable by the Chinese tax authority.

Withholding tax is withheld by the entity in China, meaning that the Chinese entity acts as the withholding agent.

The CIT withholding tax rate consists of the CIT rate of 25% times the deemed profit rate. The deemed profit rate ranges from 15%-50% and will be determined by the local Chinese tax authority. It is a common practice for the tax bureau to accept a 40% deemed profit rate, resulting in a withholding tax rate of 10%. It is however possible to apply for a lower deemed profit rate, but the company will have to provide proof to apply for a lower profit rate. Nevertheless, at the end of 2022 and at the start of 2023 we have observed that the tax bureau generally accepts a 30% deemed profit rate, resulting in a withholding tax rate of 7.5%. If a foreign company is a resident in a country or area that has a Double Tax Agreement (DTA) with the People's Republic of China, and where a lower withholding tax rate is specified within the DTA for certain criteria, the foreign company can apply to use the reduced withholding tax rate.

Individual Income Tax

Another key tax affecting companies and individuals in China is the Individual Income Tax (IIT) and other payroll taxation such as social security. For the calculation of IIT, the authorities have determined nine categories of income and levy different tax rates dependent on the source of income. Comprehensive tax, which include the four most common sources of income, is taxed on a progressive tax rate system from 3% to 45%. Operating income will also be taxed according to a progressive tax rate, from 5% to 35%. Lastly, income from interest, dividend and bonuses, income from the transfer of assets, income from leasing of property, and incidental income is taxed separately at a fixed rate of 20%.

You can read more about Individual Income Tax in section 5: Taxation.

Applicable VAT rates in China

As highlighted above, for small-scale taxpayers the applicable VAT rate will be 3%. For general taxpayers, the following VAT rates apply:

ITEMS	VAT RATE
<ul style="list-style-type: none"> Sales or importing of goods Labor services Tangible movable property leasing services 	13%
<ul style="list-style-type: none"> Transportation services, postal services, basic telecommunications, construction services, real estate leasing services, selling real estate and transferring of land use rights Sales and importing of: <ul style="list-style-type: none"> Grain and other agricultural products Tap water, heating, air-conditioning, and gases and coal products Books, newspapers, magazines, audio-visual products and electronic publications Feed, fertilizer, pesticide, agricultural machinery and agricultural film 	9%
<ul style="list-style-type: none"> Services, including: <ul style="list-style-type: none"> Modern services Value added telecommunications services Financial and insurance services Lifestyle services Sales of intangible assets 	6%
<ul style="list-style-type: none"> Exported goods Cross-border sales of services Cross-border sales of intangible assets 	0%

VAT calculation

The calculation for VAT payable differs between general and small-scale taxpayers. Below we elaborate on how these calculations work:

General VAT taxpayer calculation method

For general taxpayers, the calculation formula is as follows:

$$\text{Tax payable} = \text{current output VAT} - \text{current input VAT}$$

The output VAT is calculated as follows:

$$\text{Output VAT} = \text{sales volume} * \text{tax rate}$$

Where the sales volume is determined as follows:

$$\text{Sales volume} = \frac{\text{sales volume including taxes}}{(1 + \text{Tax rate})}$$

The input VAT can be deducted from the output VAT to arrive at the tax payable. However, not all input VAT can be deducted. In order to deduct any input VAT, the company must receive a special VAT fapiao where the tax amount is specified, and this amount must be verified in the online system of the tax bureau.

If the current output VAT is higher than the current input VAT, this will result in a payable for the company. If the current input VAT is higher than the output VAT, the amount of input VAT that is not deducted can be carried forward to the next period.

Small-scale VAT taxpayer calculation method

The calculation method for small-scale taxpayer is a simplified calculation, as they are not able to deduct input VAT. Therefore, the calculation formula is as follows:

$$\text{Tax payable} = \text{sales volume} \times \text{tax rate (3\%)}$$

Where the sales volume is determined in the same manner as in the general taxpayer calculation method above.

INDIRECT TAXES/TAXES ON TRANSACTIONS

Value Added Tax

There are two main types of indirect taxes in Mainland China: VAT and Consumption Tax. Since its introduction in 1984, China's indirect tax system has undergone significant changes in recent years. Most notably is the introduction of a single Value Added Tax (VAT) system for goods and services. VAT is applied as a percentage to the sale and import of goods in or to China, as well as the provision of services in or to China. Further reforms are expected in the next years as the draft VAT law is pending approval by the State Council and National People's Congress which will enact a formal VAT legislation.

Companies in China will have to file VAT on monthly or quarterly basis. General taxpayers have to submit their VAT filings on a monthly basis, whereas small-scale taxpayers can submit their VAT filings on a quarterly basis. The monthly or quarterly tax filing deadline is the 15th day of the next subsequent month (i.e., the tax filing deadline for the month of February is March 15th and the deadline for the first quarter is April 15th). If the 15th falls in a weekend, the deadline will be moved to the next Monday. Furthermore, due to public holidays, the monthly/quarterly tax deadline may be altered pending a notification from the tax authorities.

VAT taxpayers categories

In China there are two categories of VAT taxpayers, based on their annual taxable income; general taxpayers and small-scale taxpayers. The threshold of general VAT taxpayers is now unified at RMB 5 million in annual sales (previously it varied across industries between RMB 500,000 and RMB 5 million). This means all companies with annual sales exceeding RMB 5 million will be a general taxpayer, companies below the threshold will be small-scale taxpayers. However, companies with an annual sales level below the threshold, can apply for general taxpayer status. In the table below we highlight the differences:

Comparison of General VAT and Small Scale VAT Taxpayers

	General VAT Taxpayer	Small-scale VAT Taxpayer
Output VAT	Yes, at various rates depending on the type of supplies made ranging from 6 percent to 13 percent	3 percent
Input VAT Credits	Yes, can generally claim for business purchases	No cannot claim
Issue Special VAT Invoices	Yes	Yes. In the past tax authorities had to issue special VAT on behalf of the small scale taxpayer however these restrictions have been reduced and small scale taxpayers can opt to issue special VAT invoices directly
Receive Special VAT Invoices	Yes	No
VAT Exemptions	No	Monthly sales up to RMB 100,000 (or quarterly sales up to RMB 300,000)

After the emergence of Covid-19, the government implemented a temporary preferential policy where the VAT rate for small-scale taxpayers was decreased to 1%. This policy was implemented in February 2020 and subsequently extended several times until the end of 2021, and even implemented until March 2022. From At the end of March 2022, the government announced that small-scale taxpayers will be exempt from VAT until the end of 2022, small-scale taxpayers were even exempt from VAT. From 1 January 2023 the VAT rate for small-scale taxpayers returned to 1% again.

VAT Refunds

In China there are two mechanism for VAT refunds. The first and most common VAT refund scheme is for exported goods. The second mechanism is for excess input VAT. Below we discuss both these mechanisms.

China Export VAT Refunds

In order to promote the export of goods, in China there is no VAT applicable to exported goods. However, when a company sources products in China, it will have to pay VAT. Normally, the input VAT could be deducted from the output VAT, but for exported goods there is no output VAT. Therefore, the government has set up a system for the refund of export related VAT refunds. Companies can claim back the input VAT paid for export sales through the monthly export VAT refund claim.

China Domestic VAT Refunds

If a company's input VAT is higher than the output VAT, the excess amount of input VAT can be carried forward to the next period. In the past, it was only possible to carry these amounts forward until it could be used to deduct the amount from output VAT. However, since 1 April 2019, taxpayers can apply for a refund of excess input VAT. In order for companies to claim a refund on the excess input VAT, the following conditions must be met:

- ▶ Starting from April 2019, incremental uncredited input VAT must remain positive for 6 consecutive months or 2 consecutive quarters; and the total amount is no less than 500,000 RMB;
- ▶ The taxpayer is a Class A or Class B taxpayer in the Chinese Tax Credit System;
- ▶ The taxpayer has good conduct in the past 36 months, meaning no engagement in tax deception, or punishment by the tax authorities for tax evasion more than twice.

Important to note is that unused input VAT balances prior to 1 April 2019 are not eligible for refund. If all above conditions are satisfied, taxpayers are allowed to refund 60% of the available uncredited input VAT; where only input VAT which can be supported by special VAT invoices or other official certificates may be refunded.

CONSUMPTION TAX

Consumption tax applies to the manufacturing, processing, importation and selling of certain types of goods such as luxury items. Consumption tax rates vary from 1 percent to 56 percent depending on the type of good, the highest rates being applied to tobacco and alcohol.

SURTAXES

Surtaxes are levied as a percentage on the amount of indirect taxes payable, such as VAT and consumption tax. In China, the following surtaxes are applicable:

- ▶ Urban construction and maintenance tax - 7% for urban areas, 5% for county areas, and 1% for other areas
- ▶ Educational surtax – 3%
- ▶ Local educational surtax – 2%

Please note that the surtaxes are not levied on VAT and/or consumption tax paid on imported goods and the sale of services/intangible assets by overseas entities.



OTHER INDIRECT TAXES

- ▶ **Customs Duty:** this kind of duty applies to goods that are imported and exported, based on the applicable regulations. Import duties are charged based on the total valuation of the goods.
- ▶ **Stamp Duty:** all businesses and individuals who receive or execute certain specified documents are subject to pay a stamp duty. The rates of this tax may vary between 0.005% and 0.1%, depending on the specific document. Examples of relevant documents on which a stamp tax may be imposed include loan contracts and property insurance contracts.
- ▶ **Real Estate Tax:** property taxes are applicable to owners or users of a building or house and is applicable at a rate of 1.2% of the original value with deductions applicable or at 12% the rental value. Tax reductions of between 10% - 30% are generally provided by local governments, and real estate tax is also deductible for CIT purposes.
- ▶ **Resources Tax:** Resource taxes are applicable to natural resources. This category is generally taxed at specific rates set out by the Ministry of Finance, on a volume or weight basis. Resources that are taxable include:
 - i. Coal
 - ii. Crude oil
 - iii. Natural gas
 - iv. Nonferrous metallic minerals
 - v. Raw ferrous metals
 - vi. Raw non-metallic minerals





A photograph of a modern building's entrance. The building features a large glass facade and a prominent yellow-lit overhang. The ground is paved with large, light-colored tiles. A semi-transparent dark blue rectangle is overlaid on the center of the image, containing the text 'TRANSFER PRICING' in white, bold, sans-serif font. Two horizontal white lines are positioned above and below the text within the rectangle.

TRANSFER PRICING



In an effort to tackle tax base erosion and profit shifting, the Chinese authorities have increasingly focused on developing their transfer pricing administration including more stringent enforcement and increasing scrutiny of related party transactions. Although transfer pricing is mostly a topic of concern for multinationals, it is a topic of increasing interest for small- and medium-sized enterprises doing business in China.



THE CHINESE TRANSFER PRICING FRAMEWORK

Transfer pricing is concerned with the prices that are applied in intercompany transactions between related enterprises which are established in different tax jurisdictions. In accordance with Chinese law, the following definitions are provided for “associated relationships” which is used to define whether enterprises are related:

- ▶ Direct or indirect ownership of more than 25% of equity interests of the other party;
- ▶ Direct or indirect ownership by a third party of more than 25% of equity interests in both parties;
- ▶ The existence of loans representing more than 50% of the total paid-up capital of the other party;
- ▶ Dependence on proprietary technologies of the other party for its business activities;
- ▶ Control of purchase and sales activities or services by the other party;
- ▶ Over half of the directors or senior management personnel of one party are appointed or concurrently hold double positions at the other party;
- ▶ Control of activities of the other party by other means, such as family members or relatives;
- ▶ Two parties with other substantial common interests.

TRANSFER PRICING DOCUMENTATION IN CHINA

The objective of transfer pricing regulation is to avoid profit shifting from higher-tax jurisdictions to lower-tax jurisdictions where there is limited or no economic activity, effectively eroding the tax base in the higher-tax jurisdictions.

The fundamental principle in transfer pricing is the “arm’s length principle” and according to this principle taxpayers should be able to demonstrate that transactions between related parties are priced similarly compared to transactions with unrelated third parties.

Although China is not a member of the OECD the Chinese authorities have developed a transfer pricing framework that is largely derived from the OECD Base Erosion and Profit Shifting (BEPS) Action Plan 13 and including some local transfer pricing regulations. The Chinese transfer pricing regime consists out of two distinct aspects:

1. Related party transactions, which must be disclosed during annual CIT filing and annual reporting;
2. Transfer pricing documentation, which must be prepared by those enterprises exceeding the established thresholds.

In 2016, the Chinese State Administration of Taxation introduced a three-tier transfer pricing documentation framework as set out in ‘Bulletin 42’ consisting out of the Master File, Local File and Country-by-Country Reporting as well as possible additional documentation in line with Chinese requirements.

Following Bulletin 42, enterprises must prepare mandatory transfer pricing documentation once they exceed specified thresholds. Below we will further enumerate upon the specific transfer pricing documentations and their respective thresholds.

Master File:

The Master File is the main transfer pricing documentation that serves to detail the transfer pricing policies and activities of larger multinational corporations. A Master File must be prepared by Chinese enterprises meeting the following thresholds:

- ▶ If the ultimate holding company of the group in which the Chinese enterprise’s financial statements are consolidated has to prepare a Master File; or,
- ▶ If Chinese enterprises have a total of annual related party transactions exceeding RMB 1 billion.

A Master File must be prepared in Chinese and in accordance with Chinese legislation, and should among others include details on (1) the investment structure, (2) description of the group business activities, (3) the group’s intangible assets, (4) the group’s financing activities and (5) financial information and tax status of the group. The deadline for preparation of the Master File is within 12 months of the end of the fiscal year of the ultimate holding company.



Local File:

In comparison with the Master File, the Local File focuses more on the Chinese enterprise and the intercompany transactions between the Chinese enterprise and related enterprises in other tax jurisdictions. A Local File must be prepared by the Chinese enterprise if the following thresholds are met:

- ▶ If the Chinese enterprise has annual related party transactions of tangible goods exceeding RMB 200 million;
- ▶ If the Chinese enterprise has annual related party transactions of intangible assets exceeding RMB 100 million;
- ▶ If the Chinese enterprise has annual related party transactions of financial assets exceeding RMB 100 million; or,
- ▶ If the Chinese enterprise has annual related party transactions of any other type exceeding RMB 40 million.

The Local File will include details such as (1) organizational- and shareholding structure, (2) information on business operations, incl. industry analysis, composition of principle activities, market position and competitor analysis, information on internal structures, functions and risks, and consolidated financial statements, (3) business strategy of each department/business segment and financial data of each type of business or product, (4) description of related party transactions, incl. transaction flow, supply chain information, supporting contracts, analysis of sales, costs, expenses and profit, information on outbound investments, related party equity transfers, related party services etc. (5) comparability analysis incl. potentially implemented transfer pricing methods and benchmarking results, and (6) a justification for the chosen transfer pricing methodology among others. In accordance with Bulletin 42, the Local File should be completed by June 30th of the following fiscal year.

Country-by-Country Reporting:

Chinese enterprises may also be required to prepare Country-by-Country Reporting in the following circumstances:

- ▶ The Chinese resident enterprise is the ultimate holding company of a group with consolidated revenue exceeding RMB 5.5 billion in the previous accounting period; or,
- ▶ The Chinese enterprise is nominated as the Country-by-Country reporting entity by the group.

In addition, the Chinese subsidiary of a group may be required to submit Country-by-Country reporting if the groups ultimate holding company must prepare the Country-by-Country reporting according to the regulations of the jurisdiction it resides in and one of the following conditions is met:

- ▶ The group has not provided the Country-by-Country reporting to the taxation authority of any jurisdiction;
- ▶ If the group has submitted the Country-by-Country reporting, but the jurisdiction in which the reporting is submitted does not have an information exchange mechanism with China; or,
- ▶ If despite the group having submitted the Country-by-Country reporting and the jurisdiction in which the reporting is submitted has an information exchange mechanism with China, but the reporting has not been successfully exchanged with China.

The content of the Country-by-Country reporting forms is in line with OECD BEPS Action Plan 13 and must be submitted with the in-charge tax authority by May 31st of the subsequent fiscal year.

Special File:

If Chinese enterprises meet the following requirements they would additionally be required to prepare the Special File:

- ▶ The Chinese enterprise has a cost sharing arrangement; or,
- ▶ The Chinese enterprise has exceeded the related party debt-to-equity ratio (5:1 for financial institutions and 2:1 for other enterprises).

The Special File should be completed by June 30th of the following fiscal year.

Transfer Pricing Requirements in China

	Applicable Thresholds for Chinese Enterprise	Filing Deadline
Master File	<ul style="list-style-type: none"> If the ultimate holding company has to complete a Master File; Annual related party transactions exceeding RMB 1 billion. 	Within 12 months of the end of the fiscal year of the ultimate holding company.
Local File	<ul style="list-style-type: none"> Annual related party transactions of tangible goods exceeding RMB 200 million; Annual related party transactions of intangible assets exceeding RMB 100 million; Annual related party transactions of financial assets exceeding RMB 100 million; Annual related party transactions of any other type exceeding RMB 40 million. 	By June 30 th of the next fiscal year.
CbC Reporting	<ul style="list-style-type: none"> The Chinese resident enterprise is the ultimate holding company of a group with consolidated revenue exceeding RMB 5.5 billion; The Chinese enterprise has been appointed the CbC reporting entity; If the Chinese enterprise is part of a group that has a CbC reporting obligation, but the CbC report was not submitted or information on CbC reporting was not exchanged with Chinese authorities. 	By May 31 st of the next fiscal year.
Special File	<ul style="list-style-type: none"> If the Chinese enterprise has a cost sharing arrangement; If the Chinese enterprise has exceeded the related party debt-to-equity ratio. 	By June 30 th of the next fiscal year.
Local File	<ul style="list-style-type: none"> All non-resident enterprises with subsidiaries or premises in China 	By May 31 st of the next fiscal year.

Related Party Transactions

In addition to the previously mentioned transfer pricing documentation requirements it should be noted that during the annual CIT filing and annual publication reporting, all foreign-invested enterprises in China should submit the “Enterprise Annual Reporting Forms for Related Party Transactions of the People’s Republic of China” and these are referred to as the so-called “Local File”. The Local File consists out of 22 forms including Country-by-Country reporting forms and other forms detailing related party transactions. According to Chinese regulations these forms should be submitted by May 31st of the subsequent fiscal year.

Transfer Pricing Methods

As mentioned previously, the most fundamental principle of selecting an appropriate transfer pricing method is the arm’s length principle. In accordance with Chinese regulations, the following transfer pricing methods are identified:

- ▶ The comparable uncontrolled price method;
- ▶ The resale price method;
- ▶ The cost plus method;
- ▶ The transactional net margin method;
- ▶ The profit split method.

Together with our Moore member firm partners, including Moore Da Hua CPA, in China and firms around the world, we are able to support with global and China specific benchmarking studies.



CUSTOMS & TAXATION



For those businesses engaged in the importing and exporting of goods to and from China, either being foreign businesses without an entity in China or foreign-invested entities in China, they should have a thorough understanding of the country's customs practices and associated tax implications.

Therefore, this chapter further discusses the Chinese customs environment, the tax impact when importing or exporting goods, the procedures and implications of operating from a bonded zone and the importance of the customs declaration process in relation to China's foreign exchange control.



THE CHINESE CUSTOMS ENVIRONMENT

The General Administration of Customs (“GAC” or “China Customs”) is a ministry-level administrative organization under the State Council which has the authority and responsibility over all customs districts throughout the People’s Republic of China. All imports and exports from the People’s Republic of China are subject to the supervision and control of the GAC.

The GAC overseas 42 customs districts which operate through a total of 678 customs bureaus nationwide. Key responsibilities of the GAC include, among others:

Port management coordination

Customs control

Anti-smuggling

Trade statistics compilation

Customs valuation and duty collection

Perform health checks at points of entry

Protect imported and exported food safety

Inspect imported and exported consumer products and bulk commodities

Import/Export License

The registration and management of enterprises engaged in customs declaration processes is regulated by the General Administration of Customs (GAC Order No. 221) and the Customs Law of the People's Republic of China. In accordance with the provision of these regulations, a company incorporated in China must obtain a customs registration permit from the local customs authority, also called an "import/export license", before it can perform the customs declaration processes.

As such, entities which do not have the aforementioned import/export license will need to rely on a third-party intermediary to support with the customs declaration process.

Companies applying for the import/export license must meet the following criteria:

- ▶ Have the qualification of a domestic enterprise as a legal person;
- ▶ The legal representative has no smuggling records;
- ▶ There is no cancellation of registration by the customs authority due to smuggling violation records;
- ▶ Have a fixed business premise and facilities necessary to engage in customs declaration services.

The company's business scope should further contain the relevant scope to engage in the "import and export" of goods or services. If the company does not possess such business scope items it will be firstly required to update its business scope accordingly with the Administration for Market Regulation (AMR).

In order to apply for an import/export license, the company must submit several materials including, among others, the Registration Form of Customs Declaration Units, a copy of the duplicate/original business license and other materials such as a Power of Attorney (in case of an entrusted agent submitting the application). A comprehensive review shall be completed by the in-charge customs authority within 20 working days of acceptance of the application and based on our experience it will take approximately 1-1.5 months to complete the application for an import/export license.

TAX IMPLICATIONS - IMPORTS

The China Customs levies duties and taxes in accordance with the Customs Law of the People's Republic of China and the import and export duty tariff schedule. We can identify three taxes applicable to companies importing products to China, namely:

1. Value Added Tax (VAT);
2. Consumption Tax (CT);
3. Customs duties.

Value Added Tax for Imported Goods

In accordance with the Announcement on Policies Concerning Deepening the Value Added Tax Reform (April 1, 2019) (hereinafter referred to as SAT Announcement [2019] No. 39), the applicable VAT rate for imported goods is either 9% or 13% (referred to as "Import VAT". The lower 9% VAT rate is applicable for certain goods within the categories of agriculture and utilities, while the 13% VAT rate is applicable to the majority of goods.

Import VAT is calculated according to the following formula:

Import VAT Payable =
Composite Assessable Price * Applicable VAT rate

Whereas the Composite Assessable Price is calculated as following:

Composite Assessable Price =
Value of Goods + Import Duty + Consumption Tax

Valuation of Goods

According to Article 2 of Decree No. 213 of the General Administration of Customs of the People's Republic of China, the customs authority shall determine the value of imported and exported goods pursuant to the principles of objectivity, fairness and uniformity. Moreover, the customs value of imported goods shall be determined by the customs authority on the basis of the transaction value, including the costs of transport and other charges associated therewith, and the cost of insurance incurred prior to the unloading of the goods at the port or place of entry within the Customs territory of the People's Republic of China.

The GAC follows the valuation principles set out in the WTO Agreement on Customs Valuation. For cases where the transaction value of the imported goods cannot be determined or the transaction value is not accepted, there are 5 other methods of Customs valuation, which China Customs applies the following method in sequential order to determine the transaction value:

1. Transaction Value of identical Goods
2. Transaction Value of similar goods
3. Deductive method
4. Computed Method
5. Fall-back method

It should be noted that Import VAT shall not be a cost for the importing enterprise as Import VAT can be deducted as relevant Input VAT provided that the company has a customs registration permit (import/export license) and is in possession of the appropriate customs declaration forms.

Consumption Tax for Imported Goods

Imported goods which are taxable under China's Consumption Tax include those goods that are harmful to health like tobacco or alcohol, luxury goods such as jewelry and cosmetics and high-end products like passenger cars and motorcycles. The Consumption Tax rate varies depending on the type of goods.

Consumption Tax is calculated according to one of the following formulas:

Consumption Tax Payable (Ad valorem method) = Taxable Sales Amount * Tax Rate

Consumption Tax Payable (quantity-based method) = Taxable Sales Quantity * Tax Rate

Consumption Tax Payable (compound tax method) = Taxable Sales Amount * Tax Rate + Taxable Sales Quantity * Tax Rate

Customs Duties

Lastly, imported materials and goods may be subject to duties in accordance with the Notice of the Customs Tariff Commission of the State Council of the 2022 Tariff Adjustment Plan (hereinafter referred to as the "2022 Tariff Adjustment Plan"), which has become applicable as of January 1st, 2022. According to the 2022 Tariff Adjustment Plan, a total of 8,930 imported items shall be subject to import duties.

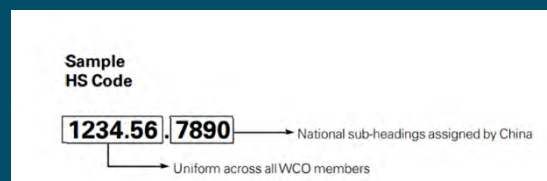
Import duty rates include Most Favored Nation (MFN) duty rates, conventional duty rates, special preferential duty rates, Tariff Rate Quota (TRQ) duty rates, general duty rates and provisional duty rates.

HS Codes

Applicable customs duty rates and import licenses/certificates for specific imported goods are determined according to the Harmonized System (HS) Code in China. In China, HS codes are divided into 22 categories, which are divided into 98 chapters.

HS codes are important because it impacts the tariff classification, customs declaration process, and the export VAT refund that applies to the product. Any mistakes or inconsistencies with the code may lead to non-compliance issues.

Since 2018, HS Codes in China consist of 13 digits. The first 8 digits in Chinese HS codes come from the WCO HS code and are followed by the commodity HS code of the "Import and Export Tariff of the People's Republic of China", "customs supervisory numbers", and the last 3 digits are related to the inspection and quarantine (CIQ)



TAX IMPLICATIONS - EXPORTS

Goods which are exported from China to abroad are in general not subject to VAT, and as a result thereof companies engaged in exporting of goods from China will have to consider the VAT rebate policy (which will be discussed below).

Export duties are only imposed on 106 export commodities as per the 2022 Export Commodity Tax Rate Table of the 2022 Tariff Adjustment Plan.

VAT Rebate Policy

As mentioned previously, exported goods are in general exempt from VAT (referred to as Output VAT). In order to obtain the benefits from the VAT exemption on exported goods, either the ECR (Export, Credit, Refund) method or LFRL (Levy First, Refund Later) method is applied to claim back part or all of the VAT on the purchase of materials for export.

According to the ECR method, exported goods are exempt from VAT. The Input VAT on purchases used in exporting is then first credited against Output VAT on domestic sales, and any excess Input VAT is refunded to the exporters.

As such, the following calculation method explains how VAT refunds are calculated:

VAT Refund =
Input VAT (on purchases) – Output VAT

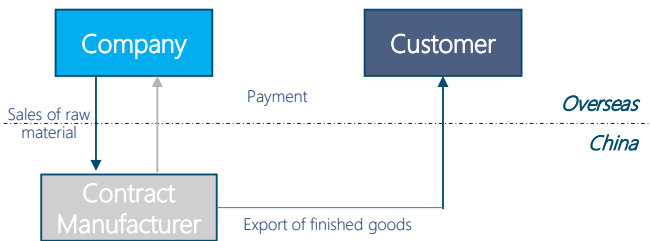
BONDED AND SPECIAL ECONOMIC ZONES

Cross-border trade with China is usually performed under two possible models: (1) General Trade and (2) Processing Trade. General Trade is the regular import channel where customs duties and import Value Added Tax (VAT) are levied upon importation. Processing trade, on the other hand, is a special operating model whereby materials to be used in the export production are imported into China under bonded status (i.e., exclusive from customs and import VAT).

Processing Trade

Processing trade is a special operating model whereby materials to be used in export production are imported into China under bonded status. All or a part of the materials are imported from overseas and re-exported as a finished product after the processing or assembly has been done by a manufacturer in Mainland China.

Under this model, manufacturers involved in the production of goods for export purposes are able to realize substantial savings upfront by importing the materials used in the manufacturing process. Each processing trade application however requires a detailed evaluation by the China customs. To be able to qualify for operations under the processing trade arrangement, manufacturers are required to comply with the requirements pertaining to the raw materials to be imported, the type of processes to be undertaken, and the sophistication of their inventory management systems, amongst others. In case the bonded materials under processing trade are used for domestic purposes, China Customs would collect the amount of duties and VAT.



Importing Processing Model

A second model is the Importing Processing Model. Under this model, a Chinese manufacturer is allowed to purchase raw materials from overseas suppliers free of import duty and VAT. It then manufactures or assembles the good and exports the finished goods to an overseas client. The title to the imported raw materials is transferred from the overseas supplier to the Chinese manufacturer.



The Contract Processing model is an alternative method to import materials with duties and VAT suspended. Under this model, the overseas supplier provides raw materials free of charge to the China manufacturer for processing. The finished goods are then exported to the overseas party. In contrast with the Import Processing model, there is no transfer of title to the raw materials under Contract Processing. The manufacturer is only compensated by the overseas party with a processing fee. If any of the bonded materials under processing trade are diverted for domestic consumption, China Customs will collect the corresponding amount of duties and VAT.

Customs Environment for Companies in Special Zones

To promote itself as a manufacturing hub, China Customs has expanded the scope of permissible bonded operations from manufacturing to include logistics operations. Major customs special supervision areas and locations include bonded logistics centers, bonded logistics parks, bonded ports, bonded warehouses, export processing zones, export supervisory warehouses and Free Trade Zones. The common factor for these special areas is that materials may be imported into these zones free from import duties and VAT under Customs' supervision.

The duty and VAT treatment for bonded goods will vary depending on the way they will be used and where the final destination will be. This is summarized in the table below.

Duty and VAT obligations for bonded goods

Use and Final Destination	Duty and VAT Obligations
Bonded goods sold between companies within the FTZ	No import duty and VAT
Bonded goods used exclusively in the manufacturing / productions of export products by companies in the FTZ	No import duty and VAT The processed bonded goods must be shipped outside China within one year.
Bonded goods delivered companies outside the FTZ for exclusive use in the manufacture of export products	No import duty and VAT if the processed bonded goods are shipped out of China within one year.
Bonded materials, parts and components sold by Companies located in the FTZ to a company located outside the FTZ (or in Mainland China)	Not considered as processing trade activities, subject to import duty and VAT
Finished goods, consisting of imported materials, are sold by a company located inside the FTZ to a company located outside the FTZ (or in Mainland China)	Subject to import duty and VAT. If the finished goods consist of both imported and domestic purchased materials, the customs shall levy duty and VAT on the amount of imported components only.
Bonded goods sold or returned to destinations in other country or regions	No import duty and VAT
Bonded goods stay within Mainland China for a period exceeding 1 year.	Bonded goods can stay in FTZ without time limit.

CUSTOMS DECLARATION PROCEDURES

When importing products from overseas into China or when exporting products from China to overseas, the Chinese importer or export (agent, distributor, or a foreign-invested enterprise) must collect the necessary documentation to perform the customs declaration procedures. The documents that typically need to be provided to the Chinese Customs agents typically include:

- ▶ Bill of lading
- ▶ Invoice
- ▶ Packing list
- ▶ Customs declaration
- ▶ Insurance policy
- ▶ Sale contract
- ▶ Inspection certificate of the AQSIQ (General Administration of the PRC for Quality Supervision, Inspection, and Quarantine)
- ▶ Other licenses of safety and quality

The customs declaration procedures can be performed directly via the customs website. To reduce customs clearance time, it is possible in certain cases to declare customs in advance and present documents after the imported products are sent, before the actual arrival of the goods in the customs zone. The Customs authorities will examine the goods directly and will release the goods after their arrival. It must be noted that import such as food and beverage products is supervised by multiple government agencies and require additional licenses and registration procedures before being able to import.

Foreign Exchange Regulations & Intermediary Trade

A common challenge for foreign-invested enterprises in China is the management of the in- and outflow of funds and making of cross-border payments due to high levels of control maintained over the foreign exchange market by the Chinese authorities. The foreign exchange regulations also have a profound impact on the customs declaration processes, where it should be noted that only the legal entity whose name is on the customs declaration forms can receive payment for goods exported from China or to make payment for goods imported into China. As such, it is essential for those businesses who wish to engage in the importing and exporting of goods to apply for a customs registration permit or import/export license.

In case a company is not in possession of a customs registration certificate it is possible for qualified intermediaries providing logistics services to support with the importing or exporting of goods on behalf of an entity incorporated in China. In order for the company in question to be able to receive payment for goods exported from China or make payment for goods imported into China the intermediary must perform a so-called “double-title customs declaration” by which method the customs declaration forms would include both the name of the logistics service provider as well as the legal entity in question.

An aerial photograph of a busy port. In the foreground, a large red cargo ship is docked at a pier. Behind it, rows of colorful shipping containers (red, orange, blue, green, and white) are stacked. Several large blue gantry cranes are positioned along the pier, ready for loading and unloading. The scene is captured from a high angle, showing the organized layout of the port.

A common challenge for foreign-invested enterprises in China is the management of the in- and outflow of funds and making of cross-border payments due to high levels of control maintained over the foreign exchange market by the Chinese authorities.

A photograph of three people in a modern office setting. A man with glasses and a dark cardigan over a white t-shirt stands on the left. A woman with brown hair, wearing a striped shirt, stands in the center holding a laptop. A man with dark hair, wearing a white t-shirt, stands on the right. They are all smiling and looking at the laptop screen. In the foreground, a wooden desk is cluttered with papers, a laptop, and some sticky notes. The background features a large green wall on the left and a glass partition on the right with some hanging plants and lights.

HR & PAYROLL



For foreign investors who want to establish or are already running an entity in China, it is important to have a comprehensive understanding of Chinese laws, regulations and processes related to human resources and payroll administration.

It is important for companies to understand that even if they employ foreign employees, having an operation in China means they are not only required to understand the regulations but also the Chinese way of working according to the culture and customs.

Over the following chapter we expand on the essential information required to ensure your business operations remain compliant with China's laws and practices.



HIRING STAFF IN CHINA

Employment contracts

A signed written employment contract between an employer and employee is a requirement for a labor relationship to be valid. The employment contract should be signed by no later than the end of the first month of employment.

If the employer does not have a signed written contract with an employee and more than one month has lapsed, the employer may be liable to pay a penalty of up to two times the employee's monthly salary. If a period of 1 year has lapsed and there is still no written agreement between the parties, it will be deemed that a labor contract with a non-fixed term will automatically come into existence.

A labor contract must contain the following information:

Details of the employer

Details of the employee

Period of employment

Working hours, leave periods and rest policies

Job description and the place of employment

The amount and terms of remuneration

Working conditions, relevant insurances and labor protection

In addition to the abovementioned mandatory clauses that need to be provided for in an employment contract, the parties can specify other terms and conditions surrounding the employment. These additional terms may include training policies, probation periods, additional insurance benefits etc.

Importance of the Employee Handbooks

The employee handbook sets out the terms and processes that are not ordinarily provided for in the employment contract. It serves as a sort of “Code of Conduct” which contains the policies that employees need to adhere to. While it is not expressly required by regulation, it can be an effective measure of protecting employers from potential labor disputes arising with employees.

In the employee handbook a company can outline important information on the rules, procedures and regulations of the company as well as the rights and obligations of employees.

Foreigners Employed in China

Foreigners who wish to be employed in China need to obtain a Residence Permit and Work Permit, to be eligible to work. Foreign employees are able to enjoy the same rights and responsibilities as local employees. Additionally, in an effort to retain foreign talent, foreign employees in China are eligible to receive preferential tax deductions until December 31st, 2023.

The categories of Work Permits have changed over the past few years and currently operates according to a points system. Work Permits are now categorized according to A, B and C classes. The calculation of points is based on different criteria such as seniority, level of education, salary, level of Chinese and time spent in China.

Probation Periods

Probationary periods are permitted in China; however, the length of time is dependent on the terms of employment. No matter the length of the employment contract, a probationary period cannot exceed a period of 6 months. An employee can only be subject to 1 period of probation at a particular company. If an employment contract is renewed, a new probationary period cannot be included.

Probation periods can be instituted as follows:

- ▶ For an employment contract that does not exceed 6 months – no probation.
- ▶ An employment contract that has no fixed term – a probationary period of up to 6 months.
- ▶ An employment contract for a period of 3 months to 1 year – a maximum of 1 month probation.
- ▶ An employment contract that has a fixed period of up to 2 years – a maximum of two months.
- ▶ An employment contract for a period of 3 years or more – a maximum period of 6 months.

LEAVE POLICIES

Annual Leave

Employees in China are entitled to annual leave based on how many years of work they have completed. The annual leave periods are as follows:

- ▶ Less than 1 year of employment – no required leave days.
- ▶ Employed for a period of between 1 – 10 years – at least 5 days of paid annual leave.
- ▶ Employed for a period of 10 – 20 years – at least 10 days of paid annual leave.
- ▶ Employed for a period of more than 20 years – at least 15 days of paid leave annually.

Sick Leave and Leave Due to Injury

Employees in China are entitled to between 3 and 24 months of paid leave due to sickness, ailment or injury. The amount of time that an employee can take as sick leave or injury leave is based on how long the employee has been working for the company. An employee who is entitled to sick leave should never receive less than 80% of the local minimum wage. For employees who have been seriously injured or who have incurred an illness while fulfilling their employment duties, they are entitled to receive up to 1 year leave at full pay.

Maternity Leave

In China, female employees are entitled to a minimum of 98 days of paid maternity leave. Female employees can begin this period of leave within 15 days prior to childbirth. In general, women are granted full pay during their period of maternity leave, which is paid either through Social Security or by their employer. Chinese labor laws are in place to legally protect women from being terminated while they are pregnant. Laws surrounding paternity leave differ by region but do not exceed a period of 14 days.

PAYROLL ADMINISTRATION

China has a complex legal framework that ensures employees enjoy a range of rights and protections. Employers in China are required to make monthly contributions to the social security scheme of employees, as well as ensure that the correct withholding taxes and deductions are made on behalf their employees. Due to the vast size of the country and the population, the level of economic development is significantly different in each city. As such, different rates and social security contributions have been imposed, dependent on the economic development of a particular region.

Individual Income Tax (IIT)

Individual income tax policies in China are applicable to all individuals who reside in or derive income from China, regardless of nationality. Tax residence for individuals is generally based on the amount of time spent in China. An individual is deemed to be a tax resident if they have been living in China for 183 days or more, in a calendar year. An individual who spends less than 183 days in China during a tax year is considered a non-resident and as such is only subject to IIT on income that has been derived from China.

The IIT system in China works on a progressive system which is based on an employee's wage bracket and ranges from 3% - 45%. It is the responsibility of the employer to withhold the taxes and make the payment to the tax bureau before the 15th day of each month. Additionally, shares tax, bonus tax and severance tax will also be withheld.

Overview of Individual Income Tax rates

Cumulative Taxable Income (RMB)	Tax Rate (%)
0 – 36,000	3%
36,001 – 144,000	10%
144,001 – 300,000	20%
300,001 – 420,000	25%
420,001 – 660,000	30%
660,001 – 960,000	35%
Above 960,000	45%

The preferential individual income tax policy, which has been extended until the 31st of December 2023, allows foreign employees to enjoy supplementary tax-deductible benefits (relating to children's educational costs, parental support, home rental expenses, critical illness, and more).

Social Security Contributions

The social welfare policies in China cover 5 types of insurance which includes: pension insurance, unemployment insurance, medical insurance, maternity insurance and work-related injury insurance. Additionally, contributions must also be made to an employee's housing fund. Employers are responsible for registering their employees with the relevant Social Insurance Bureau and Housing Fund Bureau.

Types of Social Security Contributions

Insurance Fund	Employer	Employees
Pension Insurance	Yes	Yes
Medical Insurance	Yes	Yes
Maternity Insurance	Yes	No
Unemployment Insurance	Yes	Yes
Work-related Injury Insurance	Yes	No
Housing Fund	Yes	Yes (optional for foreign employees)

The Social Security contributions for China's major cities are as follows:

Social Security Contributions

	Beijing		Guangzhou		Shanghai	
Social Benefits	Employer	Employee	Employer	Employee	Employer	Employee
Pension insurance	16%	8%	14%	8%	16%	8%
Medical and maternity insurance	9.8%	2% +3 yuan	6.35%	2%	10.5%	2%
Work injury insurance	0.2% - 1.9%	NA	0.2% - 1.4%	NA	0.16%-1.52%	NA
Unemployment insurance	0.5%	0.5%	0.32%, 0.48%, 0.8%	0.5%	0.5%	0.2%
Housing fund	5% - 12%	5% - 12%	5% - 12%	5% - 7%	5% - 7%	5% - 12%
Total	31.5% - 40%	15.5% - 22.5% +3RMB	26% - 34.5%	15.5% - 17.5%	25% - 34%	15% - 22%



TERMINATION OF EMPLOYMENT

China's labor laws and regulations have been implemented and developed to protect employees and their interests in the workplace. Companies operating in China need to ensure the protection of employees' wellbeing in order to remain compliant with local regulations.

The termination of employment in China can occur in one of two ways namely either upon expiration of the labor contract or through early termination. For many companies labor issues arise in the case of early termination. In China, an employer is unable to unilaterally terminate an employment contract without fault or at will, unless certain statutory grounds exist. An employment contract is generally terminated on one of the following grounds:

1. Termination by mutual agreement between the parties
2. Termination due to fault or misconduct by the employee
3. Termination without fault
4. Wrongful termination

1. Termination by mutual agreement between the parties

This occurs when an employer and employee mutually agree to terminate the relationship. In such cases it is common for an employer to make severance payment to the employee, in order to obtain the employee's consent.

2. Termination due to fault or misconduct by the employee

This occurs when an employer terminates the employment contract due to a material breach which can be attributed to fault or misconduct by the employee. In the case of termination due to fault or misconduct, an employer is not required to make severance payment to an employee. This includes cases where:

- ▶ An employee has not met the minimum requirements or satisfied the employment conditions during the probation period.
- ▶ An employee has seriously neglected their duties or has received benefits at the expense of the employer, which resulted in the severe damage of a company's interests.
- ▶ An employee has seriously violated a company's internal rules and procedures.
- ▶ An employee has established an employment relationship with another employer which has a material effect on the completion of tasks with their current employer and the employee refuses to rectify the situation after it has been pointed out.
- ▶ An employee has coerced, deceived or taken advantage of an employer which is against the employer's interests.
- ▶ An employee has committed a crime.



3. Termination without fault

Termination without fault occurs when an employer terminates the employment contract for reasons which are not related to misconduct or other causes. If a termination without fault is made, the employer is required to provide at least 30 days advanced written notice or pay a 1-month salary in lieu of the notice. In addition to the notice or payment in lieu of notice, an employer is also required to pay severance pay to an employee.

Particular groups of employees are not able to be terminated without fault, which include pregnant woman and employees who have lost the capacity to work due to injury or disease contracted during employment. Circumstances where termination without fault occurs, include:

- ▶ If an employee has been sick or incurred a non-work-related injury and after the conclusion of the statutory medical treatment they are still unable to engage in the original work as per the employment contract.
- ▶ If an employee is considered to be incompetent and remains incompetent after further training or they have been reassigned to another position.
- ▶ If the performance of work stated under the original contract becomes impossible due to a material change in circumstances, from the time the employment contract was entered into, and consensus has not been reached after negotiation between the parties.

4. Wrongful termination

Any other type of unilateral termination by an employer is considered a wrongful termination. If an employee is terminated wrongfully, the dispute can be settled through a settlement payment, arbitration, or litigation. In cases of wrongful termination, it is possible for an employee to seek reinstatement. If an employee does not wish to be reinstated or if the conditions for reinstatement are not possible, the employer will be required to pay double the amount of severance that would ordinarily be paid if the employee was terminated in a lawful manner. During the time period where an employee has been wrongfully terminated and is not working, an employer may also be required to make salary payments.

Mass terminations

In the context of an employer terminating the employment relationship with either 20 or more employees or 10% of their workforce this would be considered a mass termination. In such cases an employer is required to provide notice to a labor union before any unilateral termination is made.

Where a material change in circumstances exists, which requires a business to terminate the employment contracts of either 20 or more staff or 10% of their workforce, an employer is required to provide at least 30 days' notice of the layoff plan to the labor union and to all employees, which must then be submitted to the local labor Bureau.

In the case of mass terminations, employees with long fixed term contracts and who are considered the breadwinners of their family, should receive priority in regards of their retention by an employer. Once an employer has submitted the plan to the local labor Bureau, they may terminate the employment relationship on the following grounds:

- ▶ The company is being restructured according to enterprise bankruptcy law.
- ▶ The company experiences severe difficulties in its operations.
- ▶ With the objective economic situation upon which the employment relationship is based has materially changed, and as such the employer is unable to perform according to the employment contract.
- ▶ The company's product line has changed, or a new technological component has been introduced which results in the amendment of business processes or methods, and after adjusting employment contracts the company still needs to downsize or reduce staff.

VISA POLICIES

When hiring foreign employees an employer is required to sponsor the visa. In China only an accredited company is able to hire foreign employees. In order to be eligible for a working visa an applicant will be classified into 1 of 3 categories:

- ▶ A-grade foreign worker (a high-level expert)
- ▶ B-grade foreign worker (a professional)
- ▶ C-grade foreign worker (low skilled worker)

Employee requirements for a working visa:

In order for an employee to be able to work in China, the applicant must have

- ▶ At least 2 years of professional experience in a related field.
- ▶ A clear criminal record and a valid background check issued by the applicant's home country.
- ▶ A valid job offer by a company in China.
- ▶ A valid passport.

What is required when applying for a Z-visa:

1. Passport- original passport, with at least 1 blank visa page and the passport must be valid for at least 6 months
2. A photocopy of the passport
3. A fully completed Visa Application Form
4. A color passport photo
5. Supporting documents- an applicant must have one of the following documents: a Foreigners Employment Permit, Permit for Foreign Experts, Registration Certificate of Resident Representative Offices or a Letter of Invitation



A man in a dark blue suit is seen from behind, holding a smartphone to his ear. He is standing in front of a modern skyscraper with a glass facade. The sky is blue with some clouds. A semi-transparent teal rectangle is overlaid on the image, containing the text "BANKING & FINANCING" in white, bold, uppercase letters. Two horizontal white lines are positioned above and below the text.

BANKING & FINANCING



Day-to-day financial transactions and cross-border intercompany transactions are key considerations for foreign companies investing in China. Due to the central bank's tight regulations on the banking system, different regulations and language barriers, it may be difficult for foreign investors to navigate the Chinese banking landscape.

In this chapter we discuss the implications of choosing a domestic or international bank, the types of bank accounts, international transactions, and intercompany loans.



THE CHINESE BANKING SYSTEM

The Chinese banking sector is the largest banking sector in the world with over USD 49 trillion in assets at the end of 2020. As such, the banking sector is a complex system with many different players and financial products on offer.

The banking system is regulated by two institutions. Initially, the system was solely regulated by the People's Bank of China (PBOC), the central bank. The central bank is responsible for formulating and implementing monetary policy, as well as maintaining the banking sector's payment, clearing and settlement systems, and managing official foreign exchange and gold reserves. Additionally, it oversees the State Administration of Foreign Exchange (SAFE) for setting foreign-exchange policies. The second institution responsible for regulating the market is the China Banking Insurance Regulatory Commission (CBIRC), who since 2003 has taken over the supervisory role of the PBOC.

The banking system itself is mainly dominated by the five largest state-owned commercial banks, who control over half of the banking sector. These five banks were the first banks that were allowed to operate commercially. The five banks are:

- ▶ Bank of China (BoC)
- ▶ Industrial & Commercial Bank of China (ICBC)
- ▶ China Construction Bank (CCB)
- ▶ Agricultural Bank of China (ABC)
- ▶ Bank of Communications (BoCom)

Other large Chinese banks include the Postal Savings Bank of China (PSBC) and China Merchants Bank, as well as many large local players such as Bank of Shanghai (BoS) and Bank of Beijing.

Since China's entry into the WTO in 2002 it has gradually opened up its banking sector to international banks. Currently over 50 international banks are active in China, mainly including banks from the United States, Europe and East Asia. The banks with the largest presence in China include HSBC, Bank of East Asia, DBS Bank, Citibank, Hang Seng Bank, and Standard Chartered.

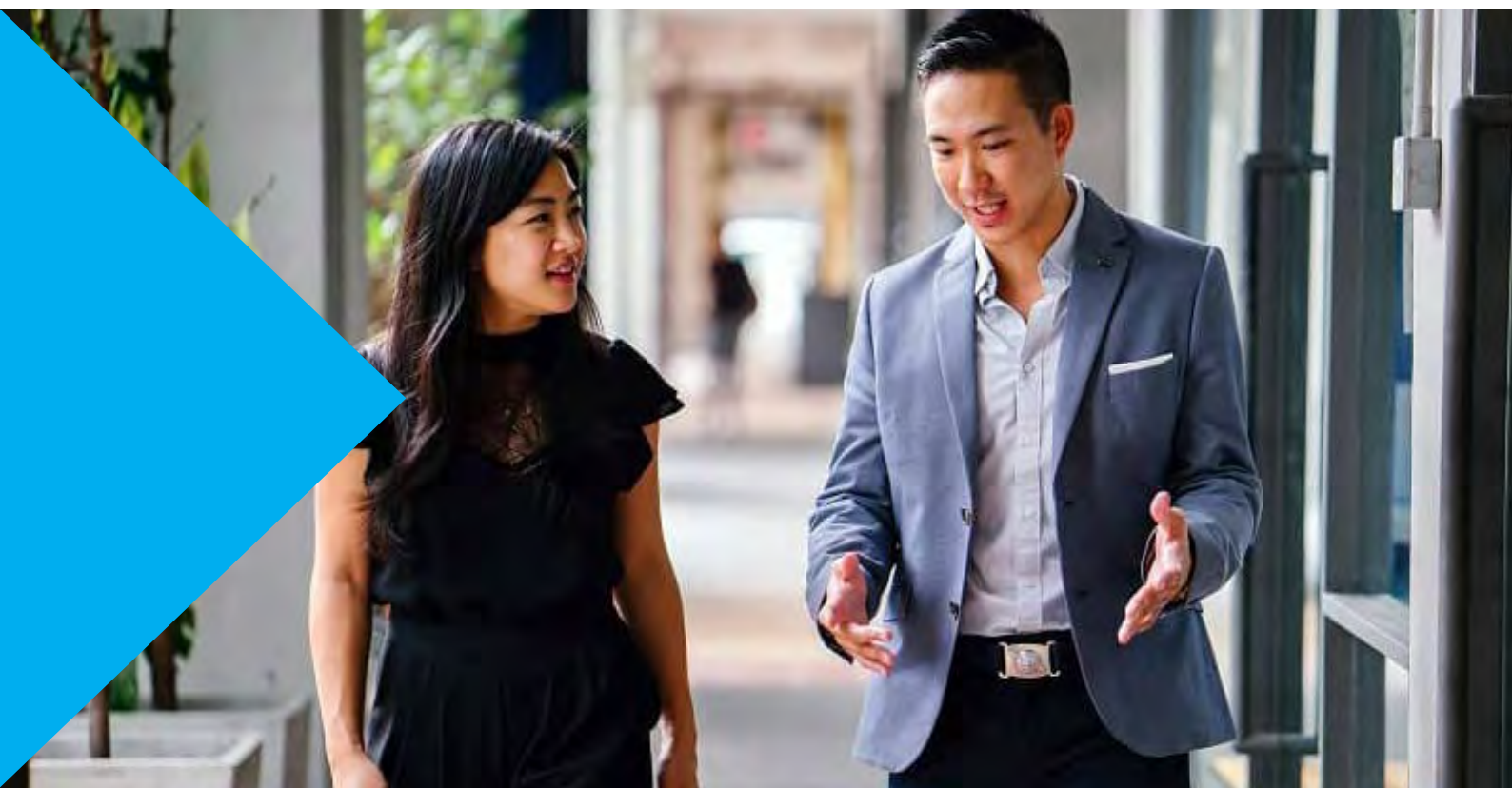
Generally speaking, smaller banks in China are less experienced in working with foreign invested enterprises and international transactions. Even within the larger banks, there are large differences on a branch level. Foreign companies often experience difficulties or rejections when handling banking matters with banks or branches that are inexperienced in dealing with international clients. Therefore, companies should always research their banking options well, before deciding on which bank and branch to use for the set up of the company's bank accounts.

Furthermore, even though Chinese banks have developed a range of banking products, from saving and investment products, to various loan instruments, the majority of these offerings are not available to foreign invested companies. External financing in particular, is extremely difficult to obtain for foreign companies. Banks generally only extend loans or other financing products to foreign entities from certain industries and of a certain size. Therefore, it is essential for companies entering the Chinese market to carefully consider how to finance the entity going forward, as options are limited.

DOMESTIC VS INTERNATIONAL BANKS

Many foreign companies prefer to set up a bank account with the local subsidiary of their international bank. This is often perceived as the preferred option due to the existing relationship and potential easier cross-border flow of funds. However, international banks do have certain limitations when operating in China. As such, we generally advise to always set up the company's main bank accounts with a Chinese bank and potentially open supplementary accounts with the headquarters' home bank if required. The main advantages of setting up the main bank accounts with a domestic bank include:

- ▶ The applications process is easier for Chinese banks compared to international banks.
- ▶ Chinese banks have significantly more bank branches which will make handling bank procedures a lot more convenient.
- ▶ Transfers between Chinese banks are faster than from a Chinese bank to an international bank, which is important as local clients and suppliers use domestic banks.
- ▶ Online banking may be limited for international banks.
- ▶ Not all international banks can link the company's bank accounts to government systems such as the tax or social security system.



TYPES OF BANK ACCOUNTS

Below we highlight the most common types of bank accounts in China.

RMB Basic Account

The RMB Basic Account is the main account of a company for daily business operations. It is the first account a company must open and will be required to open any further bank accounts. The RMB Basic Account is the only bank account that allows cash withdrawals and often acts as the company's account for salary payments and tax payments. As China facilitates the linking of the tax system with the bank account for automatic tax payments, it is advised to check with your bank whether the account can be linked to the tax and social security systems.

According to the regulations set out by the People's Bank of China (PBOC), a company can only establish one RMB Basic Account with a single bank. Upon opening of the account, the company will receive a Bank Opening Certificate, which will be required for certain applications with for example government institutions.

For the daily transactions the company can make use of the online banking system. Normal domestic transactions can all be completed through the use of the online banking tokens. As discussed in the compliance chapter, the bank will provide the company with two tokens, a preparation token and an approval token. With the preparation token, the local staff of third-party provider can prepare all payments for approval of the approval token holder. Normally, the finance responsible person of the foreign investor will hold the approval token and approve all payments before they are processed.

Even though the RMB Basic Account is mainly used for transactions in RMB, it is possible to receive funds from abroad in different currencies on the RMB Basic Account. However, when the funds arrive, you will have to arrange for the bank to convert the funds into RMB before they arrive on the bank account. Please refer to the international transactions section below to learn more.

Foreign Capital Account

The second account that Foreign Invested Enterprises need is the Foreign Capital Account. This account is used to receive the capital injections from the foreign shareholder. We always advise to set up the Foreign Capital Account with the same bank as where company has opened its RMB Basic Account. The approval to open the account is issued by the State Administration of Foreign Exchange (SAFE). However, the bank will handle the opening procedures on behalf of the company, so the company won't have to deal directly with the SAFE. The investor can choose the currency in which the company wants to inject the capital. The capital can only be injected in that currency. It is also possible to denominate the registered capital in RMB, but then the company will need to purchase RMB to transfer in the registered capital. Therefore, we advise to denominate the registered capital in USD, EUR or GBP.

Please note that after the creation of the foreign capital account and injection of the funds, the company can generally not freely start using the funds. The company can either make payments directly from the Foreign Capital Account based on an invoice and contract or convert the amount through a petty cash conversion onto the RMB Basic Account. Petty cash can be used for daily and monthly payments such as salaries, rent and tax payments. However, most banks do have limits on the maximum amount of petty cash conversion in one time, ranging from USD 50,000 to USD 200,000 or a currency equivalent. After the first petty cash conversion, the company will be asked to provide proof of the use of the funds when the company will do another petty cash conversion in the future.

Current Account

Next to the RMB Basic Account and the Foreign Capital Account, the company can open additional current accounts. Generally, there would be two purposes for opening such an account.

Firstly, sometimes companies want to open a bank account with the Chinese subsidiary of the bank they use in their home country. Because some of the functions of foreign banks may be limited in China, they chose to set up the RMB Basic Account with a Chinese bank, but still open a current account with their house bank for international transactions.

Secondly, companies may choose to open a foreign currency account, if their entity deals in many international transactions from China. Even though the RMB Basic Account can receive and send out foreign currency, the amount will not be converted from and to RMB. Therefore, opening a foreign currency account can provide a good option for companies with many international transactions occurring with their Chinese entity.

Please note that a foreign currency account can only support one currency.

Loan Bank Account

In order to receive a loan in China, a company is required to open a special, dedicated loan bank account. Moreover, every different type of loan agreement requires a separate loan bank account. It is not possible to use the same loan bank account for difference loans. Please refer to the section below on intercompany loans for more information on loans.

CHINA'S FOREIGN EXCHANGE REGULATIONS

A common challenge which foreign-invested enterprises in China experience is the in- and outflow of funds and making of cross-border payments. The reason for this is that the Chinese authorities retain a high level of control over the foreign exchange market and cross-border capital flows.

Here the State Administration of Foreign Exchange, also commonly referred to as the 'SAFE', plays an essential role for companies in China. The SAFE is part of the People's Bank of China and is the regulatory body which is responsible for governing China's foreign exchange market and overseeing the foreign exchange of the RMB.

Although some of the responsibilities of the State Administration of Foreign Exchange relate to policy formulation, it is expected that all foreign-invested enterprises in China will have to deal directly or indirectly with the SAFE in some instances. Generally, whenever funds are transferred to or from a foreign country, the SAFE will be involved. It is necessary to obtain foreign exchange approval from SAFE for among others:

- ▶ All capital account transactions (e.g. related to the registered capital account);
- ▶ For current account transactions (local banks implement approval process as set out by the SAFE);
- ▶ All company loans (inward and outward) are under scrutiny of the SAFE.

The above occasions include among others bringing in of the registered capital, service fee payments, profit repatriation, trade payments, and loan and interest related payments.

Over the past years the SAFE has delegated most of the approval responsibilities to the banks. Banks will screen the necessary documents on behalf of the SAFE and execute the transactions should these meet the necessary requirements. However, approval for trade payments, accounts payable extensions and loan extensions still must be filed directly with the SAFE.

INTERNATIONAL TRANSACTIONS

Due to the strict control on foreign exchange by the SAFE, companies can not freely transfer funds in and out of the country. All international transactions will need to be cleared by the SAFE. However, nowadays the majority of the approval process has been outsourced by the SAFE to the banks. The company's bank will require the company to submit certain documents in order to process incoming or outgoing international payments.

When an international payment is payment to a Chinese company, the funds will arrive at the bank, but will not be injected onto the company's bank account but held by the bank until the required documents are submitted. The required documents can generally include an invoice and contract for the corresponding payments. These documents will have to be physically submitted to the bank stamped with the company chop.

When a company wants to transfer funds to an international bank account, the bank will also require documents to process the transaction. The most important document to provide is proof that the (withholding) taxes have been paid or that taxes do not apply to the transaction. Furthermore, an invoice and contract will be required for the transaction.

INTERCOMPANY LOANS

Another financing option is intercompany loans between the parent company and the Chinese subsidiary in China. There are two types of intercompany loans:

- (1) The Parent Company lends funds to the FIE in China
- (2) The FIE lends funds to the Parent Company through an offshore intercompany loan.

Inbound Intercompany Loans

When a loan is provided by the Parent Company to the FIE in China, the FIE usually pays interests to the Parent Company. These interest payments are deductible for CIT purposes if the amount is reasonable and, thus complies to the arm's length principle. Disproportionally high interest rates will be deemed as non-deductible by the tax bureau. Additionally, interest payments are also non-deductible when the FIE's capital consists of a greater proportion of debt than equity. In this case, the thin capitalization principle states that the debt-equity ratio of 2:1 cannot be exceeded. When the loan and its interest payments comply with the abovementioned rules and regulations, the interest payments will be deemed as expenses and deductible for CIT. Similar to most service fees and royalty arrangements, interest payments are subject to withholding tax, VAT (6%) and surtaxes.



Recently China's largest banks are working on setting up procedures to handle incoming and outgoing international payments through the online banking system. The company will still be required to submit the required documents, but these procedures will be handled digitally. This improved procedure will save companies a lot of time and money completing international transactions.

The total amount the Parent Company can loan to its Chinese subsidiary is limited according standards set by the government. There are two methods to determine the permitted total loan amount:

Financing Gap Method

The Financing Gap is the difference between the total investment and registered capital of the Chinese subsidiary. According to the Financing Gap method for foreign debt, the sum of the accumulated amount of medium- and long-term foreign debts and the balance of short-term foreign debts borrowed by subsidiaries of foreign-invested enterprises in China should not exceed the amount of the Financing Gap.

Net Asset Method

According to the Net Asset method, the maximum amount of overseas financing for an enterprise is 2 times the value of its audited net assets. The recognition of net assets must be based on the net assets in the latest annual audit report, meaning the latest audit report is used as a parameter to calculate the amount of foreign debt that can be borrowed.

Important to note: foreign-invested enterprises in China may choose either the Financing Gap method or the Net Assets method to apply initially for a foreign loan. Once the company has selected one method, it is not allowed to switch method for future loan applications. Therefore, it is essential to carefully consider the choice of the method when applying for an intercompany loan.

Outbound Intercompany Loans

Another loan option available in China is an outbound loan, i.e. a loan from the Chinese entity to the Parent Company. It should be noted that all business-related taxes should have been levied on the funds before these are being provided as outbound intercompany loans.

There are two options for Foreign Invested Enterprises to extend a loan to their Parent Company, namely loans valued in foreign currency regulated by the State Administration of Foreign Exchange (SAFE) or loans valued in RMB regulated by the People's Bank of China (PBOC). In both cases, loans can only be extended to companies with a certain equity relationship to the lender. Depending on which method is chosen, there are certain limitations in the amount and application procedures differ.

All interest payments by the Parent Company to the Chinese FIE are deemed as income and therefore subject to 25% CIT and 6% VAT in China.



An aerial photograph of a massive container port, likely in Hong Kong, showing rows of colorful shipping containers, large gantry cranes, and a city skyline in the background under a cloudy sky. A semi-transparent dark rectangle is overlaid in the center, containing the text "PROFIT REPATRIATION" between two horizontal white lines.

PROFIT REPATRIATION



A key challenge for many Foreign Invested Enterprises (FIEs) in China is how to repatriate funds out of the country, due to the strict regulation on foreign exchange. Therefore, it is critical for foreign investors to understand the legal challenges associated with cash repatriation at an early stage and build a solid strategy early on. This will ensure that the profit is repatriated within the desired timeframe and without encountering complications.

Generally speaking, the most common methods of repatriating funds out of China include (1) Issuing Dividends to the Parent Company and (2) Intercompany Payments (Service Fees, Royalties and Reimbursements).

In this chapter we discuss how all these repatriation methods work, the taxes that are applicable and common challenge and opportunities related to these procedures. The overview will provide companies with the required knowledge to decide which method is most suitable for the company, to ensure that the funds received by the Parent Company are maximized and the tax burden is minimized.

DIVIDEND DISTRIBUTIONS

When a foreign investment company generates a profit, it can choose to re-invest these funds in the business or to issue a share of this profit as a dividend to its shareholders, proportional to the shares owned by each shareholder. This means that a Foreign-Invested Enterprise (FIE) in China can also remit a share of its profit to the Parent Company abroad as a dividend. Both Wholly Foreign-Owned Enterprises (WFOE) and Joint Ventures (JV) can repatriate profits. Only the profits that are repatriated outside of China are subject to withholding tax. Thus, the distributed profits from a JV to the Chinese investor are not subject to withholding tax (please note, however, that other personal taxes may be applicable).

Before being able to pay out dividends from China, the company must comply with the following requirements:

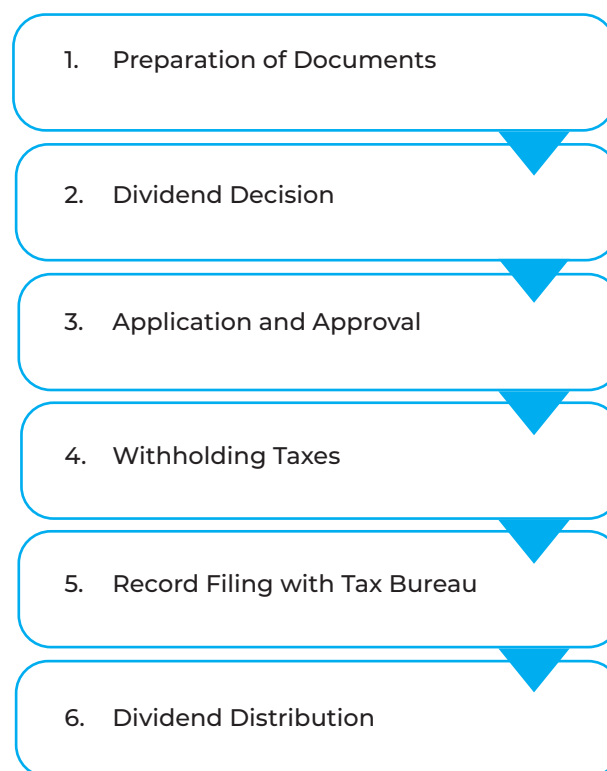
1. **Losses Compensation:** Dividends may only be paid when the accumulated losses of previous years have been made up. The remaining (positive) balance will be available to be repatriated as dividends. The maximum amount of dividend that can be distributed is mentioned within the audit report.

2. **Annual Audit and Annual CIT Tax Filing:** Profit can only be repatriated after the firm has undergone the annual audit and completed the annual corporate income tax (CIT) filing at the local tax authority. The State Administration of Taxation (SAT) reviews the audit to check whether all Corporate Income Tax (CIT) has been paid, before profits can be repatriated. This is why companies generally pay out dividends after April/May of the following year.

3. **Company Reserve Fund:** Firms are obliged to put 10% of the after-CIT profit in a company reserve fund. This process continues until the total amount of reserves within the fund reaches 50% of the registered capital of the firm.

Dividend Distribution Procedures

When following a dividend distribution as profit repatriation strategy, the company must follow the steps as enumerated below in order to remit dividends out of China:



Key to note here is that before the company can pay out any dividends, it must first receive approval from the SAFE (step 3). Here the company will need to provide several company documents (such as audit report and CIT filing), as well as a profit distribution resolution and dividend decision, and file a formal application.

Upon approval from the SAFE, the company will need to file for the withholding taxes with the Tax Bureau. The standard withholding tax rate on dividends is 10%. However, the company can also apply for a lower withholding rate, if such a preferential rate is specified in the Double Taxation Agreement (DTA) between China and the headquarters' home country.

When the withholding tax filings have been accepted by the Tax Bureau and taxes have been paid, the company will receive a certificate from the Tax Bureau, which will be required at the bank.

Lastly, the company can take the approval certificate from the SAFE and the Tax Bureau to the bank to process the dividend distribution payment.

Dividend Tax Deferral Policy

Since 2018 there is a dividend tax deferral policy in place for foreign investors who would directly re-invest their attributable profits from their FIE back into China for particular projects promoted by the Chinese government. Within this method, you will not distribute profits to overseas, but will re-use these profits within China for further business development. Provided certain criteria are met, such as that the investment can only be made in non-prohibited projects as set out by the government and that the re-investment must be equity investments, companies will be able to defer the withholding taxes payable on the dividends.

INTERCOMPANY PAYMENTS

A second method for companies to repatriate funds out of China is the use of intercompany payments. In China, companies can make use of service fee payments, royalty fee payments and reimbursements. A main advantage of these intercompany payments is that these transactions can be deductible from the CIT taxable income, meaning that payment of CIT is avoided when using this option.

When choosing this method, it is important that the content of the fee or reimbursement arrangement is supported by a contract and corresponding invoice. Secondly, the payment must be based on the arm's length principle, meaning that the fees should be priced the same way as if the two companies involved were both independent. If this is not the case, the tax bureau might impose additional CIT on the payments, since in this case the tax bureau will deem this amount not as an expense for the local company.

Service Fees

When choosing the method of service fees, it is most important to accurately describe the nature of the service in the service agreement between the FIE and its Parent Company. The services performed by the Parent Company should fit within the business scope of the entity. Tax authorities can become suspicious and challenge the service agreement, and if deemed illegitimate, they could impose additional taxes on the arrangement. If services are deemed as China-sourced income, the tax bureau will also impose a withholding tax.

The procedures to pay out a service fee are as follows:



As can be seen from the figure above, the procedures are largely similar to the process for a dividend distribution. However, there are fewer documents required for the approval from the authorities. Generally speaking, the only documents required for service fees are the contract and invoice to prove the validity of the service fee payment.

The invoice should include the taxes payable. Service fees are subject to Value-Added Tax (VAT), which is either 3% for small-scale taxpayers or 6% for general taxpayers. The service fee charged includes the payable VAT. Along with the VAT, other surtaxes are imposed on the VAT rate, such as the Urban Construction and Maintenance Tax (UCMT), the Education Surtax (ES) and the Local Education Surtax (LES). The total amount of surtaxes usually sums up to 12-13% of the amount of VAT payable (depending on your district) – which is added to the 3% or 6% VAT.

A withholding tax must be paid depending on the nature of the service and whether the service is performed offshore or within China and whether a PE is constituted. The withholding tax consists out of the CIT rate of 25% times the deemed profit rate – as mentioned before, based on our experience the tax bureau often accepts a deemed profit rate of 40%, resulting in an effective withholding tax rate of 10% ($25\% \times 40\% = 10\%$). However, it is possible to apply for a lower deemed profit rate. Moore – MS Advisory has successfully supported many clients in applying for a lower profit rate and hence a lower withholding tax rate.

After taxes are filed and paid, the company receives a certificate from the Tax Bureau, which should be shown to the bank to process the payment.

Royalty Fees

Royalties are payments charged for the use of intellectual property (intellectual and otherwise), copyrighted works, franchises or natural resources. When charging royalties, a royalty agreement must be drafted and registered at the trademark bureau. In order to receive royalties, the Parent Company is required to be deemed as the beneficial owner of these royalties. This means that the Parent Company must own and control the source from which income is derived.

The procedures to pay out royalty fees are largely the same as service fee payments:

1. Contract Registration
2. Application and Approval
3. Tax Filing
4. Record Filing with Tax Bureau
5. Payment

The difference with service fees is that the royalty contract must be registered with the trademark office. Similar as the payment of service fees, royalties are subject to VAT and surcharges. In addition, withholding taxes must be paid. The default withholding tax rate for royalties is 10% but can be reduced to a lower rate depending on the applicable DTA.

Reimbursements

There are situations in which the Parent Company incurs costs on behalf of the FIE. These costs can be refunded as reimbursements. A common example is the salary for expatriates working in China that are paid or incurred by the Parent Company. It is important that these expatriates have paid their individual income tax in China before salary costs are reimbursed. When the amount is below the limit of 50,000 USD, salary costs can be reimbursed to the Parent Company without the involvement of the Tax Bureau. Reimbursements higher than 50,000 USD need to be accepted by the Tax Bureau and a Tax Certificate needs to be obtained, which is necessary to get the payment approval from your bank. The most important documents needed for the reimbursement of expatriate salary are (1) the tax slip stating that the individual income tax in China is paid, (2) the invoice stating the specific amount of salary costs and (3) the reimbursement contract between the FIE and the Parent Company (corresponding with the year of the invoice).

Other examples of reimbursements could involve costs for IT facilities used by the FIE while the Parent Company is incurring all the costs. In such cases, the FIE can refund (part of) these costs as reimbursements. Since it is sometimes difficult to distinguish between Service Fees and Reimbursements, the Tax Bureau interprets certain reimbursements as service fees resulting in the payment of withholding CIT, VAT and surtaxes.



KEY CONSIDERATIONS

Intercompany payments to an overseas entity have come under increased scrutiny from the Chinese tax authorities. This is particularly the case for management fees paid by the Chinese subsidiary to the parent company or royalties paid for the use of intangible assets provided by the overseas entity. Most important is that these services have provided a benefit to the company in China and are priced according to the arm's length principle.

When choosing one of the repatriation strategies, it is important to understand (a) the amount of taxes that are required to be paid, (b) the specific requirements of the repatriation strategy and (c) the mandatory procedures that need to be followed. Essentially, the main objective is to maximize the funds received by the parent company and to minimize the tax burden. Additionally, many countries worldwide have signed Double Taxation Avoidance Agreements with China, and as such it is essential to review the DTA between China and your home country and assess whether your company can minimize the tax burden on the funds that are to be repatriated. Chinese authorities do not automatically apply preferential DTA tax rates and the Chinese subsidiary needs to apply for them.

When employing any of the repatriation strategies, foreign-invested enterprises in China must realize that a tax burden will arise when repatriating funds from China. Since every company is different, there is no one fits all solution to the question of which repatriation strategy to employ.

FINAL THOUGHTS

The Moore MS Advisory Complete Guide to Doing Business in China comes at a pivotal time for investors who are considering starting or expanding their operations around the globe. Amidst the backdrop of the COVID-19 outbreak and restrictions, as well as the shift the global trade environment is currently undergoing, there is a great deal of uncertainty surrounding investment. Despite the strict response to the pandemic, China still offers tremendous opportunity for the investors who are searching for diversification and growth.

Amidst the ever-changing landscape in China, businesses need to be mindful of the continually changing environment on the various levels. It has never been more important for businesses to ensure they remain in compliance with Chinese regulations, especially as China ushers in the next stage of their economic development.

With extensive knowledge on the Chinese market, we understand that the challenges and uncertainties faced today can present real opportunities and rewards tomorrow. Our comprehensive guide sets out all the information needed to set up a business or understand the business landscape in China.



MOORE MS ADVISORY

MS Advisory is a financial advisory firm based in Shanghai, which is part of Moore Belgium and a member of the Moore Global Network. Since 2011, we have supported foreign enterprises across all provinces of China and in Hong Kong with Accounting-, Tax, Compliance, Payroll- and Corporate Services.

Our mission is to provide a full range of financial services to foreign enterprises, where we focus on delivering transparency, compliance and sustainability to your business. We commit ourselves to provide our clients with a good understanding of administrative and reporting requirements in China and ensure they have full control over their finances.

For more information on this subject, please do not hesitate to contact us.

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