



# BAKER TILLY INTERNATIONAL

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COUNTRY

Doing Business in  
China



# Preface

This guide has been prepared by Baker Tilly China Ltd, an independent member of Baker Tilly International. It is designed to provide information on a number of subjects important to those considering investing or doing business in The People's Republic of China (PRC). Those considering investing or doing business in China's special administrative regions of Hong Kong and Macau should consult separate publications.

Baker Tilly International is the world's 8th largest accountancy and business advisory network by combined fee income, and is represented by 138 firms in 104 countries and over 24,000 personnel worldwide. Its members are high quality, independent accountancy and business advisory firms, all of whom are committed to providing the best possible service to their clients, both in their own marketplace and across the world.

This guide is one of a series of country profiles compiled for use by Baker Tilly International member firms' clients and professional staff. Copies may be obtained from Baker Tilly China Ltd or any of our independent member firms.

Doing Business in China has been designed for the information of readers. Whilst every effort has been made to ensure accuracy, information contained in this guide may not be comprehensive and recipients should not act upon it without seeking professional advice. Facts and figures presented are correct at the time of writing.

Up-to-date advice and general assistance on China matters can be obtained from Baker Tilly China Ltd; contact details can be found at the end of this guide.


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# 1 Fact Sheet

## Geography

Location	East Asia
Area	9,596,960km <sup>2</sup> – the world's 3rd largest country
Land boundaries	Mongolia (to the north); Russia (to the north-east); Kazakhstan, Kyrgyzstan and Tajikistan (to the north-west); Afghanistan and Pakistan (to the west); India, Nepal and Bhutan (to the south-west); Burma, Laos and Vietnam (to the south); North Korea (to the east)
Coastline	32,000km on the Pacific Ocean
Climate	A notable monsoonal trait. Cold and dry in the winter; hot and wet in the summer. It is hotter and more humid in the south and colder and dryer in the north. The January mean temperature is much lower than that experienced in other countries at the same latitude; mean temperature in July is also much higher
Terrain	Highlands in the west and lowlands in the east with various landforms made up of highlands (33%), plateaux (26%), basins (19%), plains (12%) and moors (10%)
Time zone	GMT +8

## People

Population	1,306,313,812 (July 2005 est.)
Ethnic groups	Han people in the majority with 55 ethnic minorities
Religion	Buddhism is the predominant faith and Islam the second largest faith. China allows freedom of worship for other religions
Language	The official language is Mandarin (Pu Tung Hwa). Within the PRC there are a number of local dialects and ethnic languages spoken and there are parts of China where Mandarin is not the predominant or preferred spoken language. Written Chinese characters are consistent and understood throughout China. English is spoken by a small percentage of the population but is the most common language used in international business. English is now taught in all junior schools as a second language

## **Government**

Country name	People's Republic of China (PRC)
Government type	National People's Congress (NPC) system
Capital	Beijing, with a population exceeding 12,000,000
Administrative divisions	The Chinese mainland is made up of 23 provinces, five autonomous regions and four municipalities directly under the central government
Political situation	The Constitution of the PRC stipulates that the country's central state organs comprise six components: the NPC, the Presidency of the PRC, the State Council, the Central Military Commission, the Supreme People's Court and the Supreme People's Procuratorate. The NPC is the fundamental decision making body in China. The Communist Party of China (CPC) is the country's sole political party in power. The General Secretary of the CPC is the Head of State

## **Economy**

GDP – per capita	18,934 Yuan
GDP – real growth rate	6.6%
Labour force	One of the major factors drawing foreign investment to China is its abundant labour force
Unemployment	4%
Currency	The Renminbi (RMB), denominated in units of Yuan (¥), Jiao and Fen (one Yuan equals 10 Jiao or 100 Fen). The exchange rate is managed (fixed on a daily basis) against all currencies

## 2 Business Entities and Accounting

### 2.1 General

The most common legal structures used for establishing a presence in the PRC are:

- A representative office (RO)
- A wholly-owned foreign enterprise (WOFE)
- An equity joint venture (EJV)
- A contractual joint venture (CJV).

An investor establishing a foreign investment enterprise (FIE) is required to meet a variety of minimum capital requirements, including:

- RMB500,000 for a company limited by shares
- US\$ or RMB paid-up capital requirements depending on the industry in which the investment is being made
- Paid-up capital requirements dependent on the total US\$ amount of the investment being approved.

### 2.2 Representative Office (RO)

A RO cannot invest in, or carry on business in, the PRC, nor can it enter into sales or trade on its own account. It can only act as the representative of its head office in a liaison, quality control, sourcing or similar role. Approval and registration of a RO normally takes 2-3 weeks and is often used as an intermediary step before establishing a WOFE.

### 2.3 Wholly-owned Foreign Enterprise (WOFE)

A WOFE can be wholly-owned by foreign companies, enterprises, other economic organisations or individuals and is the legal entity most frequently used by foreign investors.

A WOFE is typically a company limited by shares and is governed by the Law on Wholly-owned Foreign Enterprises. The legal representative of a WOFE has the power to represent the enterprise and, therefore, the articles of association must spell out, in detail, the scope of the representative's authority.

Capital may be contributed in cash or tangible assets with a minimum 30% cash contribution. When capital is contributed in instalments, an immediate 20% contribution is required and the final instalment must be within two years of issuing the business licence.



There is no mandatory management structure for a WOFE, but the articles of association must define the structure in detail and specify procedures for termination, liquidation and amendment of the articles.

## **2.4 Equity Joint Venture (EJV)**

An EJV is typically used for long-term projects and is formed jointly by foreign and Chinese companies, enterprises, other economic organisations or individuals. An EJV is typically a limited liability company.

Contributed capital becomes an investor's ratio of capital and voting power. A minimum 25% foreign participation is required. Capital is contributed in the form of cash although, under certain conditions, tangible assets or intangible assets can be contributed.

An EJV must have at least three directors, including a chairman and a vice chairman. The directors must meet at least once a year and make all major decisions. Some decisions require the unanimous agreement of the directors. An EJV does not fix the number of managers, but must include a general manager (no nationality requirement) and a deputy general manager.

## **2.5 Contractual Joint Venture (CJV)**

CJV structures are often adopted for shorter-term projects or build-operate-transfer projects, and are formed with joint capital or terms of co-operation between foreign and Chinese companies, enterprises, other economic organisations or individuals. A CJV can register as a company, but this is not mandatory.

Capital is contributed in an agreed ratio and may take the form of cash, land use rights, technology (patented or unpatented), materials and equipment, trademarks and other property rights. Parties to a CJV share profit in the ratio determined in the contract and not according to investors' respective contributions.

A CJV is governed by the Law on Co-operative Joint Ventures and requires a venture to have either a board of directors or a joint management committee. The chairman of the board or the head of the management committee serves as the legal representative of the CJV.

## **2.6 Other Business Entities**

The PRC has established the legal framework for other business structures such as partnerships, but foreign investors have preferred to use investment vehicles that provide them with greater legal certainty.

## **2.7 Audit and Accounting Requirements**

1 January to 31 December is the mandatory accounting year. All FIEs are required to be audited. Financial statements must be presented in Chinese in accordance with Chinese GAAP.

The PRC currently uses two accounting systems:

- New Chinese GAAP (NCGAAP), which is close to IFRS
- Old Chinese Accounting Standards (OCAS) and Accounting Regulations for Business Enterprises (ARBE).

Companies listed on Chinese stock exchanges are required to adopt NCGAAP. Unlisted companies still apply OCAS and ARBE. A conversion date for unlisted companies has yet to be set.

## **2.8 Filing Requirements**

The annual business licence renewal process requires all FIEs to submit their financial statements and auditor's report (together with other documents specified in their business licence) by 30 April.

## 3 Finance and Investment

### 3.1 Investment Approval

Foreign investors must obtain approval before establishing or investing in the PRC. The PRC maintains a Foreign Investment Catalogue (FIC) to guide the approval of FIEs. The FIC encourages investment in modern agriculture, high technology industries, modern services and infrastructure.

Regulations categorise foreign investment as either: encouraged, restricted, prohibited or permitted. The FIC provides details of the first three categories and permitted projects are deemed to be all projects not listed.

The Catalogue of Encouraged Hi-tech Products for Foreign Investment encourages investment in electronic information, software and outsourcing services, aviation and spaceflight, advanced manufacture, biology, medicine and medical appliances, new materials, new and high efficiency energy, environmental protection, earth and ocean sciences and applied nuclear energy technology.

The FIE approval process typically involves 15 separate applications divided into:

- Investment approval
- Business registration.

The approval and registration process is completed at provincial government level, although some investment proposals may require national government approval. The application process can vary significantly from location to location and can take 2-3 months, or longer, to complete. A business licence must be renewed annually.

### 3.2 Exchange Control

Foreign exchange controls allow convertibility on current account, impose controls on capital items, and supervise and manage the foreign exchange business of financial institutions.

Technically, China has removed all restrictions on payments by enterprises for imports, labour and services, repayment of interest on foreign debt and the repatriation of profits, but offshore remittances require approval by the State Administration of Foreign Exchange (SAFE). With the exception of trade goods, approval is not provided unless an application is supported by documentation including proof of taxation.

Approval of transactions on capital account is closely scrutinised by SAFE and the investment approval authorities and can be a time consuming process.

### **3.3 Banking and Sources of Finance**

The banking system comprises: state-owned or controlled banks, other banks and foreign-funded banks. State-owned and controlled banks constitute the largest component of the banking system. Foreign banks can get approval to incorporate in China and operate as Chinese banks. A number of foreign banks have incorporated in the PRC and more will do so when they obtain the necessary licence.

Non-bank financial institutions include: trust and investment corporations, securities companies, insurance companies, finance companies, leasing companies and credit unions.

The banking system is highly liquid and most forms of business financing are available. A foreign investor may find obtaining funding difficult or more expensive until they have established good banking relationships. The government closely manages the banking system and may impose lending or capital restrictions on individual banks or the banking sector, affecting the availability of financing from time to time.

### **3.4 Tariffs**

Import duties are generally imposed on imported goods. The rates imposed are either general rates or preferential rates where the PRC has a reciprocal tariff agreement with the exporting country. Customs duty and VAT are exempt on equipment imports by an FIE which form part of its total approved investment. Exemptions may also be available for imports encouraged under the FIC.

Export products manufactured by an enterprise, except those prohibited from exportation by the state and those subject to other state regulations, are exempt from export tariffs.

Imports necessary for an enterprise to produce exports are regarded by Customs as bonded commodities.

### **3.5 Investment Incentives**

Investment incentives are largely tax driven and are focused on designated industries.

Industries and projects encouraged by the government will be provided with tax exemptions or tax reductions for a period. The “encouraged categories” include: agriculture, farming, fishery, physical infrastructure encouraged by the state, environmental protection, energy and water saving and qualified technology transfers. There may be sub-sectors of these encouraged categories where foreign investment is prohibited or restricted. The period for which an incentive will be available has not been announced. Income tax rate reductions of 100% and 50% will apply.

An income tax rate of 15% will apply for high or new technology ventures eligible for key support from the state.

Research expenditure for new technology, new products and new craftsmanship are allowed an additional deduction of 50% of actual cost.

A 10% investment tax credit is available for qualifying expenditure on fixed assets for environmental protection, energy and water conservation and production safety.

Venture capital enterprises may be eligible for a reduction in taxable income for investments in encouraged SME high technology enterprises.

# 4 Employment Regulation and Social Security

## 4.1 Entry Visa and Work Permit Requirements

Foreigners visiting China for business must approach Chinese business associates and obtain a letter of invitation. A visa may then be obtained from an embassy or consulate.

A FIE intending to employ an expatriate applies to the authorities for an Employment License for Expatriates (ELE). Once the ELE is issued, the FIE may then apply for the Professional Visa Notification (PVN). The expatriate then applies for a Professional Visa with a copy of the PVN and the original of the ELE. Within 15 days of entering China the expatriate then applies for their Employment Certificate (EC). With the EC, the expatriate then applies for a Residence Certificate (RC). It is common for an expatriate employee to be in China on a business visa during the above process.

Foreigners seeking employment can enter China on an occupational visa but can only be employed after obtaining the EC and RC.

## 4.2 Hiring Local Employees

A FIE can hire local employees of its choosing. A RO can decide which Chinese nationals it would like to employ but must then contract with an employment agency to employ them and attend to their withholding tax and social security levies. Often this service is provided by the Foreign Enterprise Service Company (FESCO), a government-owned agency, but other independent agencies can be used.

## 4.3 Trade Unions and Employment Law

Employment contract law requires;

- Employers to formulate rules and regulations governing the workplace
- Discussion and negotiation with employees, their representatives or trade unions of any rules that directly relate to the interests of employees
- Written contracts to be signed or to deem open-term contracts where there are no signed contracts
- Open-term contracts once two fixed-term contracts have been completed
- Maximum probationary periods to be set
- Reinstatement or penalties for illegal dismissal.

The law establishes maximum severance pay entitlements and penalty pay rates where contracts have not been signed. The law encourages trade unions but they currently do not have a significant influence. The use of strikes or the withdrawal of labour is not common.

#### **4.4 Social Security**

Municipal governments regulate social security, which includes personal account (pension), housing fund and insurances such as medical, unemployment, pregnancy and work accident. The contribution rates and calculation basis change from location to location. The rate applied to employees can be as high as 20% in total, whereas employers may have to pay up to 50% in total of the employee wage.

In most locations, social security levies are required for all Chinese nationals and not required for expatriates.

# 5 Taxation

## 5.1 Jurisdiction and Administration

The National Tax Bureau administers income tax, value added tax (VAT), consumption tax and customs duty.

Local tax bureaux administer business tax, land appreciation tax, buildings tax, stamp duty and vehicles and vessels tax.

A 31 December tax year is mandatory.

An enterprise must file provisional income tax returns monthly. Instalments are calculated on actual quarterly or monthly profits. Final settlement of annual income tax liabilities is required by 31 May. Self assessment has not been adopted and returns must be filed regardless of whether there is a profit or loss.

Tax law allows for the imposition of penalties and interest for tax avoidance and evasion.

## 5.2 Corporate

The corporate income tax rate is 25% for all enterprises, except for small-scale enterprises and enterprises that are approved for tax incentives.

The net taxable income of an enterprise is determined after deducting reasonable expenses, costs, tax losses and other expenditures related to income. Tax grouping is not permitted.

An enterprise established under PRC law or established under a foreign law but with its place of effective management in the PRC is considered resident. An enterprise that has been established under a foreign law with its place of effective management outside of the PRC is considered non-resident.

## 5.3 Depreciation

Depreciable assets are written off on a straight line basis over their effective life after allowing for a residual value (normally 5-10%). The minimum effective life of assets has been determined by the tax authorities to be 20 years for buildings, ten years for production equipment, five years for operating equipment and three years for electronic devices.



The cost of intangible assets, excluding goodwill, can be amortised on a straight line basis over not less than ten years. Business start-up costs can be capitalised and amortised over three years.

#### **5.4 Losses**

An enterprise may carry forward tax losses for five years but no carry back is permitted. There are no loss transfer provisions.

#### **5.5 Thin Capitalisation**

Thin capitalisation rules have been introduced but the calculation has yet to be defined.

#### **5.6 Transfer Pricing**

The PRC has introduced transfer pricing rules and has published draft regulations to give effect to these rules. The regulations and rules generally follow OECD standards and require enterprises to lodge certain information with their income tax return as well as to prepare supporting evidence and information available for disclosure to the authorities at short notice.

#### **5.7 International**

Non-resident enterprises are subject to withholding tax on dividends, royalties, interest, rentals, capital gains or other income derived from sources in the PRC. Tax regulations currently impose a withholding rate of 10%. The PRC's enforceable tax treaties are listed in Appendix 1.

#### **5.8 Individual**

The income tax rates applied to individuals with PRC sourced income are set out in Appendix 2.

Whether an expatriate will be subject to income tax in the PRC will depend on the length of their stay in the PRC, whether the employer deducts the cost in the PRC and whether they are considered domiciled in the PRC.

Expatriates may become subject to PRC tax on their worldwide income if they are a resident of China over an extended period.

## 5.9 Indirect

### VAT

There are four VAT rates:

- For sale or import of goods and providing processing and repair services – 17%
- For sale or import of grain, edible oil, coal gas, natural gas, coal products for civil use, books, newspapers, magazines etc – 13%
- For small VAT payers – 6%
- For exported goods, except those subject to special state provisions – 0% (refer below).

Special state provisions provide for six tiers of VAT refund rates for exported goods – 17%, 13%, 11%, 9%, 5% and 0%. The refund rate applied to specific exported goods depends on PRC policy settings from time to time.

### *Business Tax*

Nine business tax rates from 3% to 20% are applied to a range of services. The most common rate is 5% which applies to all business services. This tax is applied as a sales tax.

### *Other Indirect Taxes*

The PRC imposes a range of indirect taxes and levies including:

- Consumption tax, imposed on goods such as rice wine, beer, petrol and diesel – 3% to 45%
- Land appreciation tax, levied on the increase in the value of land at the time when title transfers
- Building tax, levied on the owner or lessee with reference to the building cost or rental income
- Stamp duty, applied to a wide range of contractual documents to a maximum of 0.1%
- Vehicles and vessels tax, levied on a tonnage or per unit basis.

# Appendix 1

## Double Taxation Agreements

The PRC has entered into treaties with the following jurisdictions:

Albania	France	Macau	Slovak Republic
Algeria	Germany	Macedonia	Slovenia
Armenia	Georgia	Malaysia	South Africa
Australia	Greece	Malta	Spain
Austria	Hong Kong	Mauritius	Sri Lanka
Azerbaijan	Hungary	Mexico	Sudan
Bahrain	Iceland	Moldova	Sweden
Bangladesh	India	Mongolia	Switzerland
Barbados	Indonesia	Morocco	Thailand
Belarus	Iran	The Netherlands	Trinidad and Tobago
Belgium	Ireland	New Zealand	Tunisia
Brazil	Israel	Norway	Turkey
Brunei	Italy	Oman	UK
Bulgaria	Japan	Pakistan	Ukraine
Canada	Jamaica	Papua New Guinea	USA
Croatia	Kazakhstan	Philippines	UAE
Cuba	Korea	Poland	Uzbekistan
Cyprus	Kuwait	Portugal	Venezuela
Czech Republic	Kyrgyzstan	Romania	Vietnam
Denmark	Laos	Russia	Yugoslavia
Egypt	Latvia	Saudi Arabia	
Estonia	Lithuania	Seychelles	
Finland	Luxembourg	Singapore	

## Appendix 2

### Individual Income Tax Rates

An expatriate's monthly wages and salaries income, reduced by RMB 4,800, is subject to following income tax scales:

<b>Monthly Taxable Income - RMB</b>	<b>Tax Rate</b>
0 – 500	5%
501 – 2,000	10%
2,001 – 5,000	15%
5,001 – 20,000	20%
20,001 – 40,000	25%
40,001 – 60,000	30%
60,001 – 80,000	35%
80,001 – 100,000	40%
100,000+	45%

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# Notes





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