Approval and Registration requirements

When establishing a business in China, it is crucial to obtain the necessary approval and complete all required registration processes with various Chinese authorities.

Subsidiary companies in China are often times referred to as Foreign Invested Enterprises (FIEs). The key approval and registrations for FIEs in China include:

1. Approval from Ministry of Commerce or Local Commission of Commerce (MOC or Local COC) for the issuance of Approval Letter and Approval Certificate

For FIEs engaging in certain industries (e.g., education and financial institution etc.), additional approval from the industry approval authorities may be required. It is advisable for foreign investors to conduct sufficient research and/or consult advisors so as to make sure they do not overlook the additional approval requirements.

2. Registration with State Administration of Industry and Commerce or local Administration of Industry and Commerce (SAIC or Local AIC) for the issuance of Business License

According to the Administrative Regulations of the People’s Republic of China (PRC), FIEs shall register with the SAIC or Local AIC to obtain Business License to legally start operation in China.

3. Registrations with State and Local Tax Bureaus (State and Local TBs) for the issuance of Tax Registration Certificate

FIEs are required to complete tax registrations with the in-charge State and Local TBs. Thereafter, they shall undergo tax assessment with the in-charge TBs in order to decide the applicable type(s) of taxes.

Choice of vehicle

China is not a new market to most of the Multi-national Corporations (MNCs). Foreign investors have been setting up their establishments in China for years. The two major forms of vehicle foreign investors uses are FIEs and representative offices (RO). With the market opening up to foreign investors and the limited allowable activities of ROs in China, FIE is a much more popular choice these days. We shall focus our discussion below on FIEs.

A FIE demonstrates great flexibility in commercial operation, administration management, tax and accounting treatment. A FIE should have no more than 50 shareholders and could set up branches which are not separate legal entities to extend its footprint in China and expand its established brands or business.

Legal status: A FIE is a separate legal entity with limited liability. The investors’ liability is limited to their respective investment contributions. The company itself is liable for its obligations only to the extent of its total assets.

Employment status: A FIE can hire local personnel directly or indirectly through qualified labour dispatch agencies.

Registration process: A FIE shall register with various government authorities in respect of the establishment, alteration or termination according to PRC Company Law and Administrative Regulations. It generally takes 15 to 25 working days to complete the registration for the company set-up.

Legal forms: The forms of a FIE may fall into:

1. Sino-foreign equity joint ventures (EJVs): EJVs are limited liability companies with joint PRC and foreign ownership. The share of results is proportional to the equity contribution of each party.

2. Sino-foreign cooperative joint ventures (CJVs): CJVs are based on contracts between venture partners. CJVs are typically formed to develop projects that have a limited duration and a specific objective, such as the development of a building, hotel or service project. CJVs offer greater flexibility in structuring capital contributions, profit and loss sharing and investment recovery.
3. Wholly foreign-owned enterprises (WFOEs): WFOEs are legal entities in China and are wholly owned by one or more foreign investors. The foreign investor has full autonomy over the management and operation of the company. A WFOE is the preferred vehicle for foreign investors if there is no compelling business reason for having a Chinese partner.

Compliance & Reporting

1. Corporate Secretarial

Goverance: It is important to recognize that the directors and supervisors of a FIE have a range of fiduciary and statutory duties and position requirements to comply with. Any actions violating PRC laws and regulations taken by the directors, supervisor and senior management may fall into civil or criminal penalties. All subsidiaries must have at least three directors and three supervisors in the board of directors and board of supervisors respectively. Exception is given to companies with comparatively few shareholders and comparatively small in scale. They may appoint one executive director and one executive supervisor instead of setting up boards of directors and supervisors.

Annual Meeting: Boards of directors and supervisors of a FIE must hold at least one meeting a year respectively. Directors and supervisors may propose holding interim meetings if necessary.

Annual Corporate Announcement: A FIE is required to complete the annual corporate announcement and file the company administrative and financial information with various PRC government authorities on an annual basis. It may affect the renewal of various registration certificates if the annual corporate announcement is not properly completed.

2. Accounting & Reporting

China's fiscal year follows calendar year i.e., starts on 1 January and ends on 31 December of the Gregorian calendar.

All Foreign Invested Enterprises (FIEs) in China are required to prepare annual financial statements, including balance sheets and income statements, and all are subject to statutory annual audit by a CPA firm registered in Chinese. Chinese Yuan (CNY) is the recording and reporting currency. Furthermore, all accounting records have to be maintained in Chinese language. However, FIEs are allowed to use foreign language accompanied with the official Chinese language in preparing their books and records.

Companies in China should adopt the accrual basis of accounting in accordance with the China Accounting and Reporting Standards; and all books and records have to be retained for at least 15 years within the mainland of China under Chinese law.

By law, any business transactions carried out in mainland China shall be supported by an official tax invoice or “fapiao” for China bookkeeping, accounting and tax compliance purposes. For some cities, for example Shanghai, the accounting software used by company for bookkeeping and accounting purposes should be examined and approved by the local financial bureau before adoption.

Profit repatriation

Before a FIE is allowed to distribute and repatriate profits outside China to its overseas parent company, the FIE must complete the following three key annual compliance requirements: (1) audit, (2) annual tax filing reporting and (3) annual corporate announcement. Only after the completion of the annual audit and completion of tax reporting can a FIE remit net profit to overseas shareholders as dividend or retain for re-investment.

However, not all profit can be repatriated or reinvested. A portion of the profit (e.g., at least 10 percent for WFOEs) must be set aside in a reserve fund account for the purpose of remedying potential future operation loss, or funding for capital increase, etc. This is treated as part of owner’s equity on the balance sheet. This account is capped when the amount of reserve funds equals 50 percent of the registered capital of the company. After the appropriation of reserve fund, the management, at its own discretion, is allowed to allocate portion of the net profit as staff bonus welfare fund or an expansion fund, although these are not mandatory for WFOEs. For companies who have reported a net loss after tax, they are not required to allocate for such funds. The remaining net profit after the above allocations is then available for redistribution. A resolution of the board of directors and an application form for the repatriation of funds can then be submitted for overseas remittance as dividends.

3. Tax

The taxing regimes in China are complex and the tax practice varies from location to location. The major China tax issues to be considered are highlighted below. The information provides it general in nature and should not be relied upon as professional advice.

3.1. Income tax

Enterprises incorporated in China and foreign enterprises with effective management located in China are treated as tax resident enterprises (TRE).

The statutory CIT rate is 25%. The withholding tax rate on passive income (such as dividends, interest, royalties and capital gains, etc.) of non-TRE is generally taxed at 10% with relief depending on the double taxation agreement.

Foreign tax credit is allowable for income taxes paid in other countries, with a cap at the China income tax payable on the same income.

Tax losses sustained by TRE can be carried forward and utilized against the succeeding five years’ taxable income. Tax loss carry-back is not allowed.

3.2 Indirect tax

In China, VAT, Business Tax (BT) and Consumption Tax are collectively called turnover tax. VAT applies to supply of goods or taxable services for consideration in PRC and importation of goods into China. The taxable services include processing services, repair and replacement services, and certain services which fall into the VAT pilot scope.

VAT payers are classified into general VAT payers and small-scale VAT payers. For a general VAT taxpayer, input VAT paid can generally be recovered by crediting against output VAT. The standard VAT rate is 17% with certain necessities being taxed at 13%.

Goods and services not subject to VAT may be chargeable to BT which is non-recoverable with certain exceptions. China aims to replace BT with VAT for all sectors by the end of 2015. Currently, certain sectors, such as financial services and insurance, real estate and construction, and entertainment services are still subject to BT. BT rate ranges from 3% to 20%.

Consumption tax applies to 14 categories of consumable goods, including tobacco, alcohol, cosmetics, motorcycles, automobiles, etc. The tax is imposed based upon sales volume and/or sales price. The tax rate ranges from 1% to 56%.

Customs

Customs duties are imposed on certain goods imported and most exported goods are exempted from custom duties.

Other taxes

Other taxes in China include individual income tax, resource tax, land appreciation tax, real estate tax, stamp duty, deeds tax, vehicle and vessel tax, land usage tax, motor vehicle acquisition tax, city construction tax, etc.

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