

DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA (PRC)

INTRODUCTION

This guide is designed to give an insight into doing business in the People's Republic of China together with the relevant background information, which will be of assistance to organisations considering establishing a business there.

The most common way of doing business is through joint ventures, wholly foreign owned enterprises and representative offices of foreign companies. This information has been produced mainly with these entities in mind. Some entities such as banks and insurance companies are subject to special regulations, which are not dealt with in this booklet.

It is essential that advice be obtained from local professional sources before any business is undertaken.

This booklet contains only brief notes and includes legislation in force as of 31 December 1999.

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KEY FEATURES OF THE PRC

General

1. Population : 1.24 billion (1998)
2. Language : Putonghua (Mandarin) is the official language. But there are dialects such as Shanghainese, Cantonese or Fukienese. After Chinese, English is the second most widely taught and spoken language, especially among the younger people. Russian is quite commonly understood by the more senior citizens.
3. Currency : The official currency is Renminbi (RMB), which is only convertible in Hong Kong (within limit) and is not freely convertible in other international exchange markets.
4. International Airports: There are international airports in major cities such as Beijing, Shanghai, Chengdu, Kunming, Tianjin and Guangzhou.
5. Weather :
 - Beijing- average 26°C in summer, 0°C in winter
 - Shanghai- mild, average annual 15°C
 - Guangzhou- average 28°C in summer, 15°C in winter
6. Visas : Required for all foreign visitors

Economy

1. Gross Domestic Product Per capita : RMB¥6,430 (1998)
2. Major industries : Textiles, fuel and energy resources, agriculture and light industry
3. Major imports : Steel, chemicals, machinery, vehicles and aircrafts
4. Major exports : Textiles, agriculture and toys
5. Principal trading partners : Hong Kong, Japan, United States, and European Economic Community

Workforce

1. Standard employment : 5-day week, 40 hours per week, legal holiday according to relevant regulations
2. Trade unions : Membership in a trade union is not compulsory but foreign investment enterprises have to support trade unions with necessary facilities

THE GOVERNMENT OF THE PRC

1. PRC is a socialist state.
2. The highest authority of the nation is the National People's Congress (NPC) which exercises legislative power via the Standing Committee of the NPC.
3. NPC has delegates from 23 provinces, 4 municipalities, 5 autonomous regions and 2 special administrative regions (SAR).
4. The State Council is the government of the PRC. It executes policies laid down by the NPC.

LEGAL AND ACCOUNTING ENVIRONMENT

Legal System

1. The People's Republic has established a formal legal system since its establishment in 1949.
2. There are four levels of people's courts: local, intermediate, high and the Supreme Court. There are also courts for maritime and military issues.

Accounting Requirements

1. The governing body of the accounting profession is the Chinese Institute of Certified Public Accountants, which is controlled and administered by the Ministry of Finance.
2. In recognition of the changing environment due to economic reform and the open policy, accounting laws and regulations have been formulated for enterprises with foreign investment. These accounting regulations are generally close to internationally recognised accounting standards, although differences exist.
3. Audits are required for enterprises with foreign investment.

CONTROLS ON FOREIGN INVESTMENT

Exchange Controls

1. Monitored by the State Administration of Foreign Exchange and the People's Bank of China.
2. For foreign investment enterprises and individuals, revenue and expenses in foreign currencies have to be deposited with or withdrawn from their accounts with the Bank of China or other authorised banks.
3. After tax profits or income of foreign investment enterprises or individuals can be remitted outside China.
4. On 1 January 1994, China undertook a reform of its foreign exchange control system and unified the then existing dual exchange rates, namely the official rate and SWAP market rate, into a managed floating rate. In 1999, the Renminbi has been floating steadily in the range ¥8.2 - 8.3 to the US dollar.

FINANCE AND BANKING

1. At present, Chinese financial institutions consist of banking and non-banking financial institutions.
2. Banking financial institutions include commercial banks and policy banks. Bank of China, Industrial and Commercial Bank of China, Agricultural Bank of China and China Construction Bank are the major commercial banks in China. In addition to these State-owned banks, there are joint-stock banks, foreign banks and local commercial banks. At present, there are three policy banks in China, namely, National Development Bank of China, Import & Export Bank of China and Agricultural Development Bank of China.
3. Non-banking financial institutions include insurance companies, security firms, trust and investment companies.
4. Two stock exchanges have been established in Shanghai and Shenzhen.
5. As the central bank of China, the People's Bank of China controls and supervises banking sectors. While China Securities Regulatory Committee plays the role of regulating body of the security industry, the newly founded China Insurance Regulatory Committee is in charge of all supervision of insurance companies in China.

INCENTIVES FOR BUSINESS ACTIVITIES

1. In general, foreign investors are encouraged to engage in the following areas:-
 - i) Production and manufacturing
 - ii) Developing export markets
 - iii) Businesses with high and innovative technology
 - iv) Infrastructural projects
 - v) Development of communications industries
 - vi) Exploitation of energy resources, agricultural, forestry and animal husbandry production
 - vii) Operations in remote locations
2. Incentives available to the above investments are provided in regulations and circulars issued by the State Council and other relevant authorities. These include tax incentives and other preferential treatment.

FORMS OF BUSINESS ORGANISATION FOR FOREIGN INVESTORS

Common forms of business establishment for foreign investors include:

- i) Equity joint venture
- ii) Co-operative joint venture
- iii) Wholly foreign-owned enterprise
- iv) Representative office

Equity Joint Venture

- i) An equity joint venture is a limited liability Chinese legal entity formed by one or more Chinese parties and one or more foreign parties under the Sino-foreign Equity Joint Venture Enterprise Law. It is a distinct and separately taxable legal entity. Basically, at least 25% of the joint venture's shareholding has to be held by foreign investor(s). The joint venture will be managed by a board of directors with appointees from both sides.
- ii) Investors in an equity joint venture share profits and losses strictly in accordance with their respective contributions to the registered capital of the venture.

Co-operative Joint Venture

A co-operative joint venture is sometimes referred to as a contractual joint venture. The establishment of a co-operative joint venture is governed by the Sino-Foreign Co-operative Joint Venture Enterprise Law. It may be formed as a separate legal entity with limited liability, or an entity similar to a partnership. Investors in a co-operative joint venture share profits and losses in accordance with the provisions in the co-operative contract.

Wholly Foreign-owned Enterprise

This kind of enterprise is 100% owned by foreign investors. The establishment of a wholly foreign-owned enterprise is governed by the Foreign Enterprise Law. It is a distinct and separately taxable entity.

Representative Office

A representative office can be set up by a foreign company to render services such as liaison, negotiation, coordination, market survey and provision of consultancy services on behalf of its home office and clients. It is important to point out that no direct business activities by a representative office are permitted.

Other forms of business set-up which are less commonly used include Chinese holding company and branch of foreign company.

TAXATION

Taxation of Companies - Income Tax

- i) From 1 July 1991, all foreign investment enterprises ("FIEs") including equity joint ventures, co-operative joint ventures and wholly foreign-owned enterprises, and all foreign enterprises ("FEs") with or without establishments in the PRC deriving profits from the PRC are subject to Enterprise Income Tax ("EIT") in accordance with Foreign Investment Enterprises and Foreign Enterprises Income Tax Law.
- ii) Any FIE is subject to EIT at a rate of 30% and a local surtax of 3% on its income derived from sources outside and in the PRC.
- iii) Any FE with an establishment in the PRC is subject to EIT at a rate of 30% and a surtax rate of 3% on its income derived from the PRC.
- iv) Any FE without an establishment in the PRC is subject to EIT at a rate of 20% on its income derived from the PRC.
- v) Taxable income includes capital gains. No withholding tax will be levied on any remittance of after-tax profits of a FIE.
- vi) Tax losses can be carried forward for 5 years but cannot be carried back.
- vii) Preferential tax treatment e.g. reduced tax rates and tax holidays, are available depending on the location of the establishment and the nature of business.
- viii) Tax year: The calendar year is used. An enterprise may adopt its own accounting date only with the approval of the tax bureau.
- ix) Accounts: Accounts are to be prepared in Chinese or in Chinese with a recognized foreign language and are kept for at least 15 years.
- x) Tax Return: Any FIE and FE with an establishment in the PRC should file quarterly provisional income tax returns and make advanced payment of tax within fifteen days from the end of each quarter. An annual return together with audited accounts should be filed within four months after the tax year. Final settlement should be made within five months after the tax year.

Taxation of Individuals

Individual Income Tax Law ("IIT Law") provides that the IIT shall be levied on the following income:-

- i) Wages and salaries;
- ii) Income from individual household business;
- iii) Income from contracting for or leasing the operation of enterprises or institutions;
- iv) Income for personal services;
- v) Income from author's remuneration;
- vi) Royalties;
- vii) Interest, dividends and bonuses;
- viii) Income from lease of property;
- ix) Income from transfer of property;
- x) Casual income; and
- xi) Other income specified as taxable by the Ministry of Finance.

Incomes (ii) and (iii) are subject to IIT at the progressive rates from 5% to 35% whereas incomes (iv) to (x) are levied at 20%.

A monthly deduction of RMB¥800 (RMB¥4,000 for foreigner) is allowed in calculating the amount of IIT payable on wages and salaries. IIT is levied on wages and salaries at the progressive rates from 5% to 45%.

Where a non-China domiciled individual working in the PRC receives wages and salaries from a foreign employer and the payment is not ultimately borne by an establishment in China, his IIT exposure depends on the length of residence in the PRC in a year as follows:-

- i) Not more than 90 days - *exempt from IIT.*
- ii) 2 More than 90 days but less than 5 years - *China-source income during the period of residence in the PRC is subject to IIT.*
- iii) 3 Over 5 years - *From the 6th year, worldwide income is subject to IIT.*

In addition, bilateral tax treaties in some cases provide an additional source of rules for interpreting the term "residence". For example, under the PRC-US Double Tax Treaty, an individual will generally be subject to IIT only if his stay in the PRC is more than 183 days in a calendar year. Where there is a conflict between the IIT Law and the term of a treaty, the treaty will prevail over the IIT Law.

An individual will be required to file IIT returns with the local tax office and pay tax on a monthly basis, either personally or through the employer within seven days after each month.

Other Taxes

1. Turnover Tax
2. With effect from 1 January 1994, a new unified turnover tax system has been introduced comprising valued-added tax ("VAT"), business tax ("BT") and consumption tax ("CT"). Please refer to the tax information sheets for the respective scope of charge and tax rates.
3. Other principal taxes levied on foreign investors include:-
 - Customs Duty
 - Land Appreciation Tax
 - Registration Fee
 - Stamp Duty
 - Urban Real Estate Tax
 - Vehicle and Vessels Operation Licence Tax

CORPORATE INCOME TAX

1. Rate : national 30% + local tax 3% except where preferential treatment is granted.
2. Tax Year : Calendar year
3. Payment : Quarterly advanced payment within 15 days after the end of each quarter, annual settlement within 5 months after each tax year.
4. Relief for losses : carry forward (max 5 years)
5. Tax incentives :
 - Tax holiday generally of 2 years' exemption and 3 years' 50% relief available to long term (10 years) production-oriented foreign investment enterprises.
 - 40% tax refund upon re-investment of profits earned by foreign investors from foreign investment enterprises on project of at least 5 years.
 - Other tax incentives depending on industry and location.
6. Withholding Tax (subject to treaty variations) :
 - Dividends, interest, rental, royalties and other income paid to non-residents -20%. Dividend income from a foreign investment enterprise (EJV, CJV or WFOE) is specifically exempted from Withholding Tax under the PRC Income Tax Law for Foreign Investment Enterprises (FIE) and Foreign Enterprises.
 - Preferential tax treatment is available for income from Special Economic Zones and for certain interest and royalties income as approved by the State Council.
7. Thin Capitalisation : Minimum ratio of Registered Capital to Total Investment of a FIE.

Total Investment (US\$ 000,000')	Minimum ratio or registered capital
up to 3	70%
over 3 less than 4.2	US\$2.1 million
4.2 to 10	50%
over 10 less than 12.5	US\$5 million
12.5 to 30	40%
over 30 less than 36	US\$12 million
from 36	1/3

TURNOVER TAX

From 1 January 1994, China has implemented a new turnover tax system, which comprises of value added tax (VAT), business tax (BT) and consumption tax (CT).

VALUE ADDED TAX (VAT)

1. According to the PRC Provisional Regulations for Value Added Tax ("Provisional Regulations"), VAT applies to individuals and enterprises on importation of movable goods into China, sale of movable goods in China and provision of processing and repairing services in China.
2. Rates :
 - 17%- Basic rate
 - 13%- Grains, edible plant oil, utilities, publications and certain agricultural products
 - 0%- Export (Pursuant to tax circulars issued subsequent to the Provisional Regulations, VAT refund rates for export sale vary depending on the specific nature of goods. Thus, VAT on export sale is in effect not subject to zero rate for certain items.)
3. VAT Payable : $\text{VAT payable} = \text{Output VAT} - \text{Input VAT during the period}$ $\text{Output VAT} = \text{Turnover} \times \text{Tax rate}$
4. However, not all input VAT paid is deductible or refundable in the determination of the amount of VAT payable.
5. Small-scale taxpayers as defined in the Provisional Regulations are chargeable to VAT at 6% on their turnover without any deductions.

CONSUMPTION TAX (CT)

1. CT is levied on individuals or entities that manufacture, subcontract or import into China of chargeable items as specified in the PRC Provisional Regulations for Consumption Tax. Those chargeable items include cigarettes and tobacco, liquor and alcohol, cosmetics, skin and hair care products, precious jewellery, firecrackers, gasoline, diesel oil, motor vehicle tyres, motorcycles and motor vehicles.
2. Rates : 3% - 40% depending on the chargeable items. Export sale is exempt from CT.

BUSINESS TAX (BT)

1. Any individual or entity who engages in the provision of services (other than processing and repairing), transfers intangible assets or sells immovable properties in China is subject to business tax in accordance with the PRC Provisional Regulations for Business Tax.
2. Rates: 3% - 20% depending on the nature of services. The majority are taxed at 3% - 5%.

PERSONAL INCOME TAX

1. Rates : Incomes including wages and salaries, income from individual household business, income from contracting or leasing operations, income for personal services, income from lease of property, transfer of property, royalties, remuneration to authors, interest, dividends and bonuses, casual income and others specified by the Ministry of Finance are subject to Individual Income Tax. Tax will be levied monthly at rates (5% - 45%) in accordance with the tax rates applicable to the type of income.
2. Deductible for employee :
 - i) Local: RMB¥800 per month
 - ii) Foreign: RMB¥4,000 per month
3. Dividends from a FIE : Non-taxable in the hands of the recipient

This booklet contains only brief notes on doing business in China. It is essential that professional advice be sought before any business is undertaken.

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