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HOW TO SELL SERVICES, CONDUCT TRADE, AND MANUFACTURE GOODS IN CHINA WITHOUT OWNING A LOCAL COMPANY?

MS Advisory

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The rules and regulations for foreign companies to do business in China can be considered as strict and for some businesses even as restrictive, However, it certainly remains possible for foreign companies to do business in China without owning a local entity. Foreign companies can sell their services in China, sell and import their goods into China and have their products produced in China, all without owning a local entity.

We can categorize these type of companies, whose management is not based in China, according to their business activities, which are:

1. Trading in China without local entity: Foreign companies can import their products in China via a distributor or via their client whom has the relevant certification to import the specific category of products into China. The distributor or client can exchange RMB to foreign currency to pay for the delivered goods and when importing the goods into China must act as the withholding agent for any taxes due on this transaction. Value Added Tax on Goods is mostly charged at 17%, however the VAT rate of 11% for specific category products is also possible. Customs duty would also need to be paid by the withholding agent and varies accordingly to the relevant HS Code for the products in China. For luxury goods or goods harmful for health of the consumers, additional Consumption Tax may be due.

2. Manufacturing in China without local entity: In this case, foreign companies would source the products from their manufacturing supplier in China. The produced goods according to the standards of the foreign company would then be exported (by the Chinese company whom is licensed to export goods) to the country of the foreign company. On most exports (except few product categories) no export VAT is levied and taxes and customs duty would be paid by the importing company in the country of the destination. It also important to realize that on these exports, and especially for Chinese companies which are focused on export industry, they could be eligible for tax rebates from the Chinese tax authorities. In addition, when goods are sold from China to foreign country and a Hong Kong company is used in between this transaction, there might be tax benefits possible within this structure.

3. Sell Services in China without local entity: When selling services to companies in China, it is important to realize that on these transactions VAT needs to be paid (6% for General VAT Tax Payer, 3% for Small Scale Tax Payer), Surtaxes of 12-13% (based on district) calculated on the total VAT amount and might even Corporate Income Tax is due if following the service agreement the foreign enterprise is deemed as having a

Permanent Establishment. This Corporate Income Tax is then calculated based on the Deemed Profit Rate on this transaction according to the tax bureau judgement (i.e. could be 30%) and following 30% would be subject to 25% Corporate Income Tax in China. The client in China would act as the withholding agent to pay the taxes in China. Since this procedure can become quite time-consuming and complicated, as of our experience we have noticed that not always the Chinese client is willing to undergo these procedures. At this moment, we have experienced that especially large enterprises in China would request the foreign company to set up a local entity in China.

As you can read from the above, it is certainly possible for foreign companies to do business in China without having a local entity. However, there are various issues and considerations you should take in mind which can make doing business in China without a local entity more complicated. We have listed main issues and considerations hereby below:

(A) Only local entity can issue 'fapiao': In China, local companies should when selling services and goods issue to their client an official Chinese invoice, which is called 'fapiao'. Only with this document, local companies would be able to deduct these expenses for CIT calculation and when companies are General VAT Tax Payer, can deduct their input VAT from their output VAT. Foreign companies cannot issue this fapiao to their local client.

(B) Only local entity can hire employees directly in China: Expatriates and the local Chinese citizens are only allowed to work for local company registered in China. However, local employees can be directly hired via labor dispatch agencies in China (such as FESCO-Adecco and others) and perform for limited period of time activities in China on behalf of the foreign entity. In this case, a service fee is paid to the labor dispatch agency, and following the agency pays the salary to the employee, and files according the individual income tax and social security on behalf of the individual.

(C) Strict foreign exchange controls in China can make it difficult to receive payments from the client without a local entity: All Foreign Exchange in China is administered by the State Administration of Foreign Exchange (SAFE) and which has imposed strict regulations on inbound and outbound transactions. Transactions above USD 50,000 or equivalent amount are required to obtain additional tax certificate from the Tax Bureau before this amount can be remitted overseas. Also, since December 2016, amounts above USD 5 million could be required to apply for additional approvals from government authorities. As of this reason and particularly from non-trade payments to overseas (i.e. services), it can be difficult to receive payments directly from the Chinese customer.

When having considerable business activities in China, but the above is creating too many problems for your business dealings in China, then it might be a good idea to consider to set up a local entity in China. At this moment, you could consider to set up a Limited Liability Company in China in the form of a Wholly Owned Foreign Enterprise (WFOE) or Joint Venture (JV) or could consider to set up a Representative Office in China. The advantage of the latter is that no registered capital contribution is required, however the scope of activities is only limited to Marketing and Research and would essentially not solve most problems as described above.

Conclusion

There are several ways of doing business in-and with China. However, the type of modus to opt for depends on the specific company, clients, the market and the level of engagement in China. At Moore Stephens, we have the professionals to advice you how to do business in China and when is the right moment to consider to set up local entity in China. For more information and any questions on how to do business in China in the most optimal way, please do not hesitate to contact us at info@msadvisory.com.