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7 THINGS YOU PROBABLY OVERLOOKED WHEN DOING BUSINESS IN CHINA

MS Advisory

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China provides many opportunities for foreign businesses, although its complexity, regulations and constant changes make it difficult to keep track on what is advised and what is required when doing business in the Mainland.

Following the experience of Moore Stephens Consulting and 1421 Consulting Group (1421), we have prepared a list of 7 things many foreign businesses have overlooked or did not think about when doing or start doing business in China.

1. Business Scope

The business scope is listed on every company's business license. Choosing a business scope is done at the beginning of the registration process. It is a very delicate moment of choosing during the registration of one's entity. The business scope defines which types of business a company can engage in and are approved by the Bureau of Industry & Commerce. In China, there are 4 types of business scope items: Common, Encouraged, Restricted and Forbidden. For more information about the different categories, please check out an earlier published article by 1421.

What companies usually do not know – or tend to forget – is that they can only pursue the items listed on the business scope. Failing to be compliant to the business scope can imply a fine up to one year's revenue.

Also, depending on the business scope, the type of company in China is different. There are three types:

1. Consulting
2. Trading
3. Manufacturing

Each type has different requirements to be set up. As a trading company is engaged into trading, it usually needs to apply for an import/export license and consequently will be registered at Customs. For a manufacturing WFOE, one needs to have a factory space in an approved zone. For example, it is impossible for a manufacturing WFOE to register in the center of (large) cities in China.

Both domestic companies as well as foreign-invested enterprises (FIE), such as a wholly-owned foreign enterprise (WFOE) and a joint venture (JV), are restricted to their business scope. A Representative Office (RO) in China, since it only can represent the headquarters of a foreign company, is restricted only to marketing activities.

2. Trademark Registration

When doing business in China or even considering doing business in China, please do not forget to register your trademarks! Only with a trademark registration within China, your trademarks are safeguarded and cannot be used

by other Chinese companies. In case of infringement, you will need strong evidence to take Chinese companies to court. Trademark registration is based on 'first-come, first-serve'; this rule means when you start the application today, no other company can register your trademarks.

Apple for example failed to register some trademark in time. They forgot to register their trademark "IPHONE" in all categories for trademarks, which allowed a Chinese company to register the IPHONE trademark, before IPHONE become a popular brand, for leather bags and accessories. Registration of trademarks is usually inexpensive, yet negligence and purchasing trademarks back from other companies is very expensive. Please consult the right IP law professionals to take care of your trademark registration.

3. Compliance in Hong Kong

Many organizations still use the Hong Kong Limited as entry door for the Chinese market. Even if not directly involved in your Chinese operations, it is still important to comply with the Hong Kong law and keep this entity operational. Keeping the Hong Kong Limited up to date implies yearly procedures, which go side by side with the annual audit. Usually, organizations have agents performing these mandatory filings. When a company is late with filing, a company receives a fine. After filing late two times, the company might have to appear before a judge in Hong Kong and the company is considered not to be compliant anymore. These are the yearly requirements for Hong Kong audits and inspections:

1. Annual inspection
2. Renewal of the Business certificate from the tax bureau
3. Renewal of the annual office in the Hong Kong office registry
4. (Zero) tax declaration to the tax bureau
5. Filing the annual return form

4. Custody of Company Chops

The company Chops are one of the most important aspects of a Chinese company. Any official company documents, such as Consulting Agreements, Labor Contracts and Termination Letters, are not legally valid if they are signed by an individual as the CEO or General Manager. In addition, they have to be chopped with the relevant Chop. Every Chinese company has several Chops, each with a unique purpose. The most important ones are listed below:

1. Company Chop
2. Legal Representative
3. Invoice Chop
4. Financial Chop

If one loses one of these Chops the company can be open to exposure and needs to go through an extensive process to obtain new stamps. Many companies use a stamp sheet. This sheet logs who used the stamps, when a specific stamp was used and for what purpose. Then, the relevant employee signs this sheet once a Chop is used. With this sheet, one can backtrack what was stamped and with which purpose.

5. Chinese Labor Contracts

Some companies are lenient with renewing or executing labor contracts, as both employer and employee trust each other. We advise our clients to have all labor contracts in place. In general, the second renewal (ie. Third signed contract) is an open term contract. However, if the employer and employee do not sign the second or third labor contract directly after the previous one has ended, the company can be open for legal exposure. Specifically, if an employee is working for a longer period of time without a contract, the employee may be entitled to double salary during this time as well as a direct open ending contract.

For the above stated reasons, it is important to carefully consider the contract length when a new employee is hired. For different contract lengths, different probations are applicable. For

example, for a 3-year contract, a six-month probation can be chosen. This in contrast to a 1-year contract, in which only a probationary period of 1 month can be given. Opting for a longer initial labor contract also delays the onset of the open term.

Moreover, we advise all Chinese company owners to have an employee manual (or the company's Rules & Regulations), and having it signed by every employee. The employee manual needs to be tailored to Chinese labor laws, and it cannot be just a literal translation from your European or American employee manual. This manual needs to clearly define everyone's job as well as describe the specific company's rules and regulations. It is the governing law for your organization (China Law Blog, 2016). If there is any change to the manual, all employees need to sign this document again to prove that they have read and understood the updated rules and regulations.

6. IIT for Expatriates

It is relatively easy to determine and calculate the individual income tax (IIT) for local Chinese employees. All local Chinese employees can only be paid via a local company in China, and individual income tax will be calculated on all (worldwide) income received.

For foreigners, it can be complicated and most of all complex to determine the effective tax rate

which depend on their residence status. Whether the foreigner needs to pay tax in its home country or China; whether he or she deemed as a tax resident; or whether the individual would be required to pay tax on its worldwide income; is increasingly complex.

We recommend consulting tax professionals to determine your individual income tax situation and assess how much tax (and social security) you are required to pay. A tax professional can also advise how to legally optimize your tax structure.

7. Who is Managing Your Bank Account?

Who has the authorization to use your bank account in China and what procedure do you use in your company to manage this accordingly? Internal control processes for foreign companies are vital to have control over the subsidiary and its activities.

Most banks in China offer the function of having a USB token to prepare payments and a USB token to approve payments. Since most Internet Banking systems of Chinese banks are also in English language, it is certainly possible as legal representative or authorized person in- or outside of China to manage this effectively. Though this creates an additional layer within your financial operations, this layer helps safeguard your financial interests in China.

Conclusion

MS Advisory and 1421 Consulting Group are only scratching the surface with these 7 points. Being compliant in China, just like any other country, is a never ending story. Continuously keeping track of your organization, the rules & regulations, taxes and audits requires dedication and carefully study over time. We assist your organization with these matters in China. Feel free to contact us with regards for any organizational advice.