



# Doing Business in China Guide

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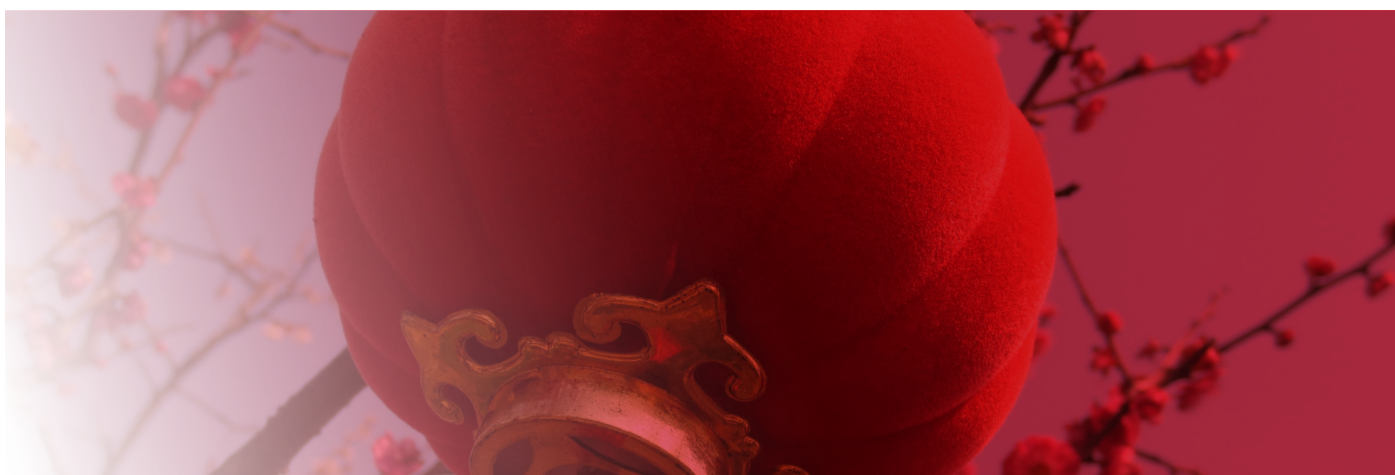




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## Introduction

The **ECOVIS Handbook “How to start up a business in China”** has been prepared to provide an overview of investment issues in China. Subjects covered include the Chinese business culture, market entry considerations, bookkeeping and audit, taxation, mergers & acquisitions, due diligence and human resources.

The first part of the handbook gives a short overview over The People’s Republic of China and its economy.

While the handbook **“How to start up a business in China”** should not be regarded as offering a complete explanation of investment issue in China, we, at **ECOVIS China** hope readers will use the handbook as their first point of reference and then use our service at **ECOVIS China** to receive specific information and advice. ECOVIS China has offices in Beijing and Shanghai.

January 2014

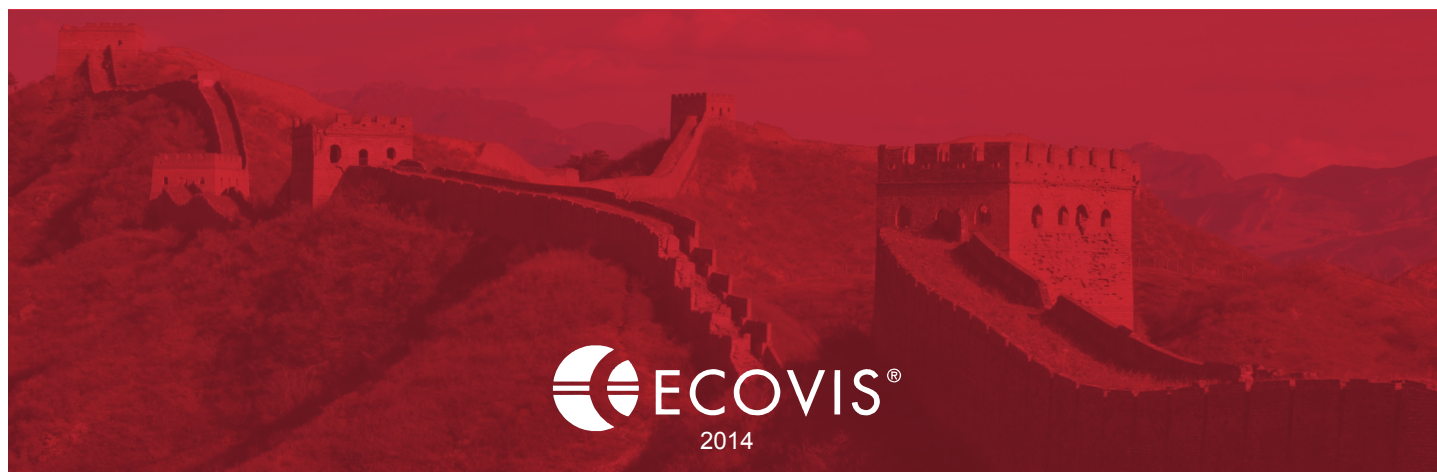
## About ECOVIS

**ECOVIS** is a leading global consulting firm with its origins in Continental Europe. It employs over 4,000 people operating in over 50 countries. Its consulting focus and core competencies lie in the areas of tax consultation, accounting, auditing and legal advice. The particular strength of **ECOVIS** is the combination of personal advice at a local level with the general expertise of an international and interdisciplinary network of professionals. Every **ECOVIS** office can rely on qualified specialists in the back offices as well as on the specific industrial or national know-how of all the **ECOVIS** experts worldwide. This diversified expertise provides clients with effective support, especially in the fields of international transactions and investments - from preparation in the client's home country to support in the target country.

In its consulting work **ECOVIS** concentrates mainly on mid-sized firms. Both nationally and internationally, its one-stop-shop concept ensures all-round support in legal, fiscal, managerial and administrative issues. The name **ECOVIS**, a combination of the terms “economy” and “vision”, expresses both its international character and its focus on the future and growth.

We of **ECOVIS China** particularly customized our advisory activities to the requirements of internationally active enterprises. We of ECOVIS China work independently, objectively and absolutely reliably. Significant for our partnership with our clients are mutual trust and the long-term personal consultation and support.

Our major clients are foreign invested enterprises from European and American countries, especially from Germany. We serve our clients over the whole territory of China.







# 1. P. R. China

## 1. The People's Republic of China

### 1.1 Business Environment

With the largest population and the fastest-growing economy in the world, China is a country that is worth to be watched closely.

Now part of the WTO, changes are happening even faster in China.

Sectors are opening up overnight, laws are being changed and more and more opportunities are presenting themselves to foreign investors.

Also, China's domestic market is becoming increasingly important, which provides foreign companies and investors with many opportunities.

### 1.2 Figures

#### General Information

**Name of the country**  
**Capital City**

The People's Republic of China (PRC)  
Beijing

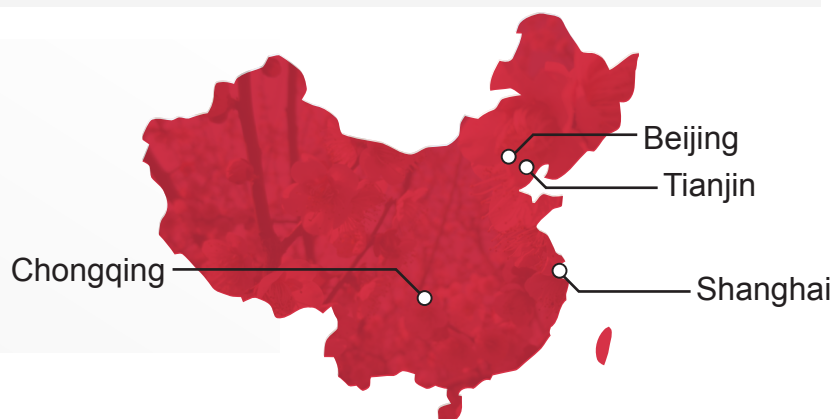
#### Population

**Population**  
**Area**  
**Allocation of population**  
Shanghai  
Beijing  
Tianjin  
Chongqing

1.351 billion (2012)<sup>2</sup>  
9.6 million sq km  
51.27 % city, 48.73 % countryside (2011)<sup>2</sup>  
23.02 million (2010 census)  
19.61 million (2010 census)  
12.94 million (2010 census)  
28.85 million (2010 census )

**Sources:** IMF, worldbank,  
[www.stats.gov.cn](http://www.stats.gov.cn)

**Right:** political map of China



## 1.3 Prospect

Despite a somewhat lower economic growth the overall economical situation is still positive and in comparison with other nations the growth is above average, the country has high foreign economic currency reserves.

- Given the enormous size of the country and the growth potential, the Chinese market is still an attractive investment market
- But: high environmental burden, unemployment, salary differentials, protectionism

## 1.4 Commercial Policy

Stimulation of:

- small-and medium sized companies
  - environmental protection
  - Effective usage of energy
  - High-technology
- 
- Annual growth rates between 7% and 10%
  - More focus on rural areas

## 1.5 Location / Development Zones

- Stimulation of former politics: east of China more developed than the west of China (85 % of foreign investments, 90 % exports)
- New “Go West policies”: development of infrastructure, tax and investment stimulation in the west of China
- Priority has the consideration of infrastructure, supplier and clients, environmental pollution, quality of living and professional staff (big differences in China!)
- Tax and investment stimulations should be considered as second step (e.g. high tech, environment, energy, infrastructure)
- Development zones are common in China



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## 1.6 Investment and Trade

- ☞ China continues to be an important location for European investments
- ☞ The interest of Chinese companies to invest in Europe increases (stimulation of the government)
- ☞ Still some IPO of Chinese enterprises, e.g. in USA and Germany
- ☞ Since 2004 China has been the most important trade partner for countries in Asia

## 1.7 Five-Years Plan

The 12th Five-Year Plan was released in March 2011 and shows the main priorities for social, economic environmental and other government policies for the period 2011-2015. A five year plan is not a law or requirement but it serves as a manual or guide for the government and also has profound implications for the private sector.

Therefore foreign investors should pay close attention to the most recent plan and take it into consideration or even as a basis when making important strategic business and investment decisions.

Goals mentioned in the plan include: Improving domestic consumption and living standards of Chinese consumers (especially in the western and central areas), fostering innovation and high-technology firms, increasing energy efficiency and environmental protection, and modernizing production processes.

Some industries which are likely to benefit from government support and incentives are:

- ☞ Biotechnology
- ☞ Next generation information technology
- ☞ New energy/renewable energy
- ☞ New materials
- ☞ Environmental protection and energy saving
- ☞ Advanced equipment manufacturing
- ☞ New-energy vehicles

While these industries will profit from government policies, other sectors (eg. polluting industries) might be more restricted.

The current five-year plan also shows that the structure of the Chinese economy is changing rapidly. It is no longer merely a cheap manufacturing country. Domestic demand is increasing and the government is likely to boost Chinese consumer spending further. Therefore China itself becomes an important sales market for foreign companies.





## 2. The Chinese Business Culture

Chinese and Western business cultures are quite different. Cultural awareness and a basic understanding of the behaviour of Chinese colleagues and business partners can be extremely useful when doing business in China.



### 2.1 Hierarchies

In the hierarchical structures of Chinese society and companies, age, position and title determine how general and business encounters are carried out. In China, the individual is subordinate to the organisation. For business meetings, people will enter the room in a hierarchical order and senior managers usually lead any negotiations or discussions. Also, Chinese introduce themselves with full titles and company name (e.g. Doctor Michael Williams, CEO of XYZ company).

It is important to respect the hierarchical order. Older employees are to be respected. Instructions by a supervisor are strictly followed. Questioning orders are seen as a sign of disrespect, especially because as a consequence the supervisor might “lose face.” *Open criticism should be avoided.*

### 2.2 Punctuality

Generally Chinese business counterparts are on time. Punctuality is important and being late is deemed disrespectful.



## 2.3 Business Relationships

Relationship (guanxi) and relationship building is essential to succeed in China and long term relationships are considered more valuable than fast transactions. Often, business deals can only be secured after trust, based on a mutually beneficial relationship has been established. Possessing good guanxi with authorities is useful to avoid difficulties and frustrations.

Hence, having a well-connected Chinese business partner can be beneficial when it comes to relationship-building, especially with the government.

## 2.4 Party Membership

The Communist Party of China (CPC) continues to play an important role, not only in politics but also in the private-sector. Most larger companies have employees that are party members and senior executives tend to have good relationships to the CPC, especially in state-owned enterprises.


## 2.5 Lian and Mianzi

The concept of face is of great importance in Chinese culture and should be considered in business interactions. It can be categorised into two types “lian” and “mianzi.” Lian represents the society’s confidence in a person’s moral character. Mianzi represents society’s perception of a person’s prestige.

If a person loses “lian” this might result in a loss of trust within a social network. If “mianzi” is lost, it results in a loss of authority.

Being responsible for the “loss of face” of a person through public humiliation or disrespect can seriously damage the business relationship with this individual. Similarly, complimenting someone in front of others is highly respected and can help with negotiations and working relationships.

## 2.6 Other Helpful Hints

 Business cards should be two-sided. One side printed in English and one in Chinese. The business card should be presented with both hands and with the Chinese side facing up. Examining it carefully is a sign of respect. Business cards should not be placed in the back pocket, as this is disrespectful.

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- ❁ Prior to business meetings in China, it is common to engage in small talk. This might include very personal questions. Often initial meetings are merely a social gathering to get to know the other part.
- ❁ Being patient is crucial for success. The Chinese sense and importance of time is different compared to western countries.
- ❁ It is common to exchange gift with business colleagues at the initial meeting. Not giving a gift might be regarded disrespectful. Especially older Chinese often refuse a gift at first to be polite. Therefore it should be offered a second time. Too expensive gifts should be avoided. Otherwise it might be seen as bribery.
- ❁ Chinese find it difficult to say “no.” To save face often Chinese rather say “maybe.” Forcing a Chinese person to say no might be damaging for the working relationship.





# 3. Market Entry

## 3. Market Entry

### 3.1 Background

There are numerous ways to invest in the Chinese market. A common way is to form a foreign-invested enterprise (FIE). Nowadays the most popular option is to establish a Wholly Foreign-Owned Enterprise (WFOE).

Over 80% of investors choose this investment vehicle when entering the Chinese market. However, there are also a variety of other options.

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### 3.2 Joint Ventures

For a long time a joint venture between a Chinese company and a foreign company was the only way for foreign investors to enter the Chinese market, especially before China became a member of the WTO in 2001. Therefore relevant legislation already exist for a long time and is very extensive and comprehensive.

For a successful Joint Venture both partners need to have the same goals.

Joint ventures have advantages and disadvantages. A Chinese partner is likely to be familiar with the local market, and might have a well established network with Chinese businesses and authorities.

One of the biggest challenges is to find the right partner and to negotiate a fair agreement. In some industries, for example in the automobile and energy industry, it is mandatory to set up a joint venture when entering the Chinese market.

There are two types of joint ventures: Equity Joint Ventures and Cooperative Joint Ventures:

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#### 3.2.1 Equity Joint Ventures

A Chinese-foreign equity joint venture is a JV structured in the form of a Chinese limited liability company to which a Chinese enterprise and a foreign party each contributes its shares of capital.

The profit distribution is made based on the percentage share of equity distribution or other neutral agreement.

Some important facts:

- Parties jointly invest and manage the JV
- Parties share profits, risks and losses according to their contributions to the registered capital
- Enterprise income tax law applicable

## 3.2.2 Cooperative Joint Ventures

CJVs are flexible with respect to capital injections, profit distribution and management structure. Cooperative joint ventures can be set up as a limited liability company or as an unincorporated business (Corporation or partnership).

Some important facts:

- Rules are less stringent
- Terms of the contract are negotiable, e.g. profit distribution
- Enterprise income tax law applicable

## 3.3 Wholly Foreign-Owned Enterprise

A Wholly Foreign Owned Enterprise (WFOE) is a limited liability company. As explained before, a vast majority of all foreign investments in China are done through a WFOE. A wholly foreign owned enterprise is, as the name implies, 100% owned by one or more foreign investors and established entirely with foreign capital. This gives the company a higher level of independence, control and security over its business activities.

In certain industries (e.g. high and new technology and equipment, development of new products as well as energy preservation) the government encourages foreign investors to set up a WFOE.

However, in certain other industries investors might be restricted or prohibited to set up a WFOE.

Other useful facts about WFOEs are:

- 🌐 100% Control
- 🌐 Cost and time saving due to not having a negotiation process with a Chinese partner
- 🌐 Intellectual Property Rights(IPR), trade secrets, technologies can be secured
- 🌐 More flexible and streamlined management systems
- 🌐 Enterprise income tax law applicable

## 3.4 Foreign-Invested Commercial Enterprise

A FICE is a relatively new investment vehicle (since 2001 after China opened this sector as its WTO commitment). The aim of introducing FICEs was to facilitate imports and exports of China sourced products for foreign investors and to avoid the need of going through an agent. It is mostly a 100% foreign owned entity with limited liability and therefore similar to a WFOE.

Other facts include:

- 🌐 Primary usage: Trading and distribution of goods as well as for retail business, franchising, import/export in general
- 🌐 No limitation for opening retail stores in China (with some restrictions, e.g. books, trading, foreign investor's share is then limited to 49%)
- 🌐 Same other advantages as a WFOE

## 3.5 Foreign-Invested Holding Company

Foreign Invested Holding Companies are Chinese-Foreign Equity Joint Ventures or Wholly Foreign-Owned Enterprises within Chinese territory that deal with direct investment or hold equity interests in other companies in China.

However, a FIHC cannot engage in production operations themselves. It is basically an umbrella structure arrangement, which enables a foreign company to hold together its foreign invested enterprises in China.





Foreign investors, who want to establish a FIHC must have a good reputation and satisfy certain minimum requirements, including a minimum amount of registered capital and subsidiaries in China. Also, the scope of activities is restricted by the government.



There is no difference to other investment vehicles regarding taxation. Dividends received from their invested enterprise are generally exempt from enterprise income tax at the holding company level.

## 3.6 Foreign Enterprises with or without Establishment in China






Foreign enterprise incorporated outside China/ with establishment:

-  *Production or business operations in China*
-  *Subject to tax to the extent for income connected with its operations*

Foreign enterprise incorporated outside China/ no establishment:

-  *No production or business operations*
-  *Subject to withholding tax on income which is derived from China*

Definition “**establishment**”, i.e., double taxation treaty between Germany and China

-  a place of management, operation or administration
-  a farm, factory or place of extraction of natural resources
-  a place where services are rendered
-  a place of construction, installation, assembly, repair and exploitation etc.
-  other establishments engaged in manufacturing and business operating activities



### Definition “**permanent establishment**”

- ☞ Management organizations, business organizations, representative offices
- ☞ Factories, farms, places where natural resources are exploited
- ☞ Places where labor services are provided
- ☞ Places where contractor projects, such as construction, installation, assembly, repair and exploration, etc. are undertaken
- ☞ Other establishments or places where production and business activities are undertaken

## 3.7 Representative Office

A representative office represents the foreign company in China. ROs are not allowed to engage in any profit making activities including manufacturing, production, sales and is prohibited to issue invoices. However, a RO may perform market analysis and coordinate marketing activities. Also, a representative office can employ Chinese citizens and up to 4 foreigners.

ROs might be useful for:

- ☞ Market research to explore the market and its opportunities
- ☞ Networking with Chinese companies
- ☞ Quality control of products distributed in China

Taxation:

- ☞ Deemed as permanent establishment
- ☞ Application for tax levying method (most are based on expenses and deemed profit rate)
- ☞ Different kind of regulations for Individual Income Tax, employment regulations

## 3.8 Branch Offices

A good expansion strategy for FIEs is to open up branch offices. It provides the company with an opportunity to open outlets in various cities without having to set up an entirely new entity. Especially restaurants, supermarkets and retail chains are using this strategy to grow. A branch office can only be opened by companies that are already present in China in form of joint venture, WFOE and FICE.

## 3.9 Domestic Enterprises

Domestic companies are established within the territory of the PRC and include:

- ☛ State-owned enterprises
- ☛ Collectively-owned enterprises
- ☛ Private enterprises
- ☛ Cooperative enterprises
- ☛ Share-formulated enterprises



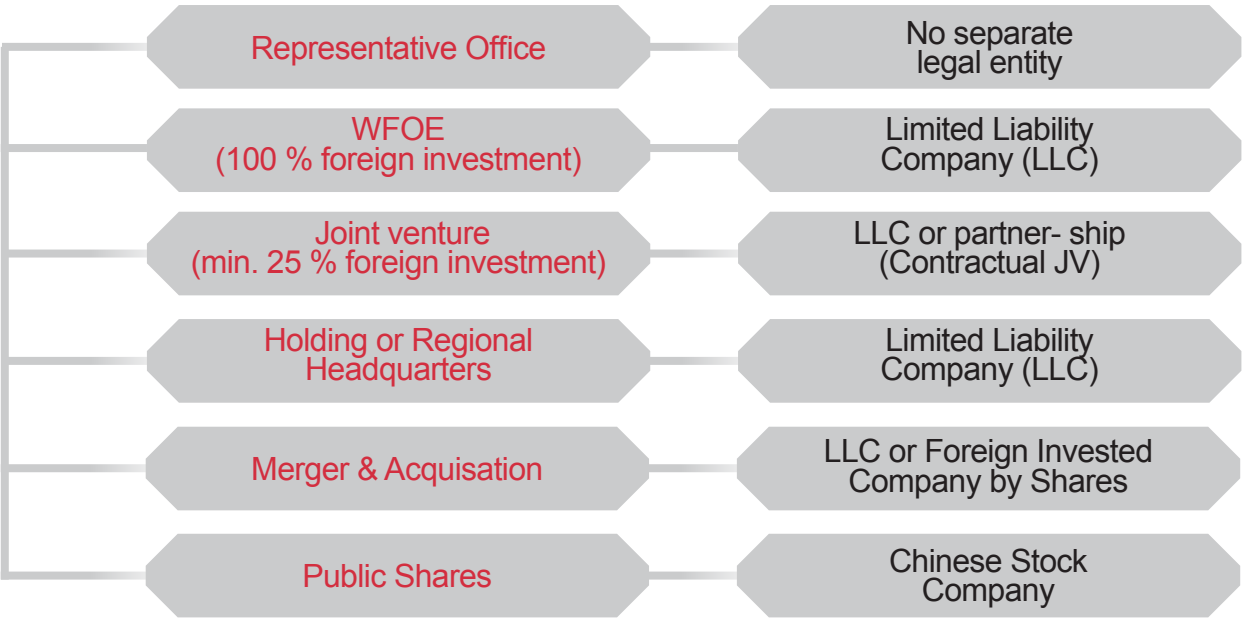


3.10 Choice of Market Entrance

The overview below shows the most important forms of investment in China. The choice of the legal form are decided as a following step.

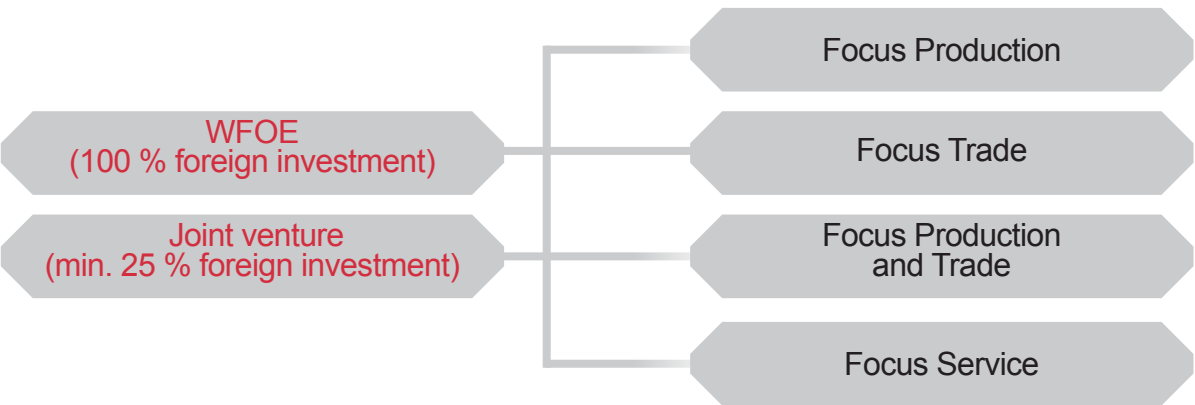
Entering the Chinese market requires a lot of strategic planning and a legal expert should be consulted for help. ECOVIS China can provide extensive advice on all issues regarding market entrance.

Choices of Chinese market entrance



For the company set up it is also important to decide in advance which kind of business scope the company will have. This decision will have influence for the registration and obtaining the business license.

New Investment



### 3.11 Pro's and Con's WFOE versus JV

| WFOE                                |  | JV   |  |
|-------------------------------------|--|--|--|
| Pro's                               | Con's  | Pro's  | Con's  |
| Fast decision making processes      | Capital contribution only from one party   | Capital from 2 or more parties   | Time and cost spending because of more effort and longer decision making process |
| Protected technologies and know-how | Limited knowledge of the Chinese market  | Share of the costs and the risk  | Technology and know-how piracy risk  |
| 100% ownership and control          | Built up relationships with Chinese business contacts and government long-term process | Use relationships of Chinese JV partner and his business and government contacts | Dependency   |
| No culture differences              |  |  | Culture differences  |



## 3.12 Capital

### Minimum capital:

- ☞ Limited Liability Company (with multiple shareholders): 30,000 RMB
- ☞ Limited Liability Company (with one shareholder): 100,000 RMB

According the requirements of the local authority a higher amount could be due.

### Balance of total investment and registered capital:

There are minimum levels to setting up a company. However it should be considered to ensure that the registered capital is sufficient for the cash flow during the start-up period. Furthermore attention should be paid to the relationship between total investment and registered capital. It should be planned to balance it correctly also regarding the financial gap, the difference between total investment and registered capital. For the requirements please see the following table:

| Total investment capital / registered capital |  |  |
|---|--|--|
| Total investment/ Mio USD                     | % of min. registered capital of total investment | Time limit for registered capital payment          |
| < 3   | 70 %   | Within 2 years after issue of the business license |
| 3 – 10  | 50 %, <i>not less than 2.1</i>                   | Within 2 years after issue of the business license |
| > 10 – 30                                     | 40 %, <i>not less than 5.0</i>                   | Case by case                                       |
| > 30  | 33,3 %, <i>not less than 12.0</i>                | Case by case                                       |

**Notes:** Payment by lump sum fee, payment within 6 months after obtaining the business license  
Installments payments: first installment min. 15 %, within 3 months





## 4. Bookkeeping & Audit

# 4. Bookkeeping and Audit

## 4.1 Annual Audit of Financial Statements

Foreign invested enterprises in China are required to prepare annual financial statements in accordance with commercial laws. The accounts need to be recorded and prepared according to Chinese accounting standards for business enterprises. These statements are the basis for calculating the taxable revenue and distributable profit as well as major documents of the annual combined audit/ inspection.

Under Chinese law the financial statements have to be audited by a certified public accountant firm which is registered in the PRC.

---

## 4.2 Foreign Currency Inspection Report

In addition to the audit of financial statements a foreign currency inspection has to be performed each year. The report about the inspection is necessary for the company to undergo the annual inspection of the State Administration of Foreign Exchange (SAFE) as required by relevant regulations regarding foreign exchange in the PRC.

---





## 4.3 Annual Tax Clearance and Annual Combined Inspection

According to the requirements of the authorities, each foreign invested company shall participate in the annual tax clearance, and a combined inspection by various authorities. Therefore 7 sets of documentations have to be prepared by the company, one for each authority as follows:

### Annual EIT Clearance

Preparation of relevant tax returns for Enterprise Income Taxes (“EIT”) compliance to be filed within the first 5 months of the coming year. Relevant tax authority:

- ☞ State Administration of Taxation (SAT)

### Annual Combined Inspection

Preparation of the relevant documents / forms within 6 months of the following year for the these authorities:

- ☞ Ministry of Commerce (MOFCOM)
- ☞ Administration of Industry and Commerce (AIC)
- ☞ Financial Bureau
- ☞ State Administration of Foreign Exchange (SAFE)
- ☞ China Customs
- ☞ Statistics Bureau





## 5. Taxation

### 5.1 Background

China's current tax system is relatively new, having been developed only since the 1980's. Prior to that, China's tax system was concerned primarily with the taxation of domestic enterprises.

With the introduction of the "open door" economic policies, the tax system was reformed and developed in order to levy taxes on foreigners, foreign enterprises and foreign investment enterprises. To attract foreigners and foreign companies to make investments in China, China issued a separate income tax law for Foreign Investments and Foreign Enterprises in 1991, which provided tax incentives and various favourable tax treatments.

Due to unfair competition over the last years, the current new Enterprise Income Tax Law (EITL) came into effect on January 1, 2008. Since then, foreign enterprises and domestic enterprises have been taxed finally under the same tax scheme. China's new VAT reform has been extended nationally on August 1st 2013.

This chapter provides a brief overview of the most important aspects of taxation in China.

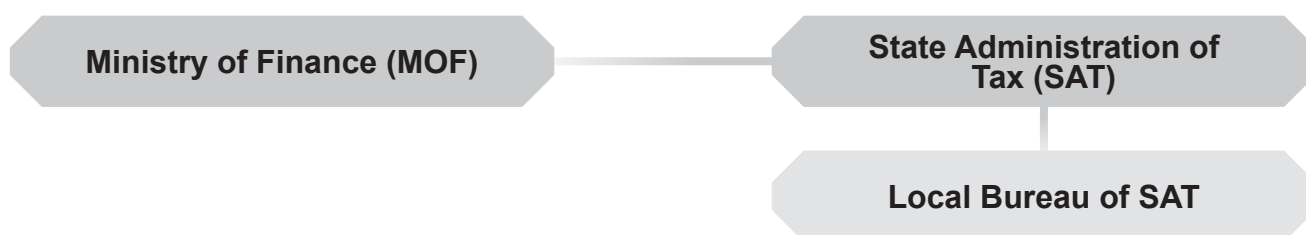
Taxation is a complex topic and legislation is constantly changing. ECOVIS China can help your company to optimize your tax burden in China while meeting the highest compliance standards.

### 5.2 Relevant Authorities

SAT and MOF are empowered to interpret the country's tax laws and regulations by the issuance of circulars.

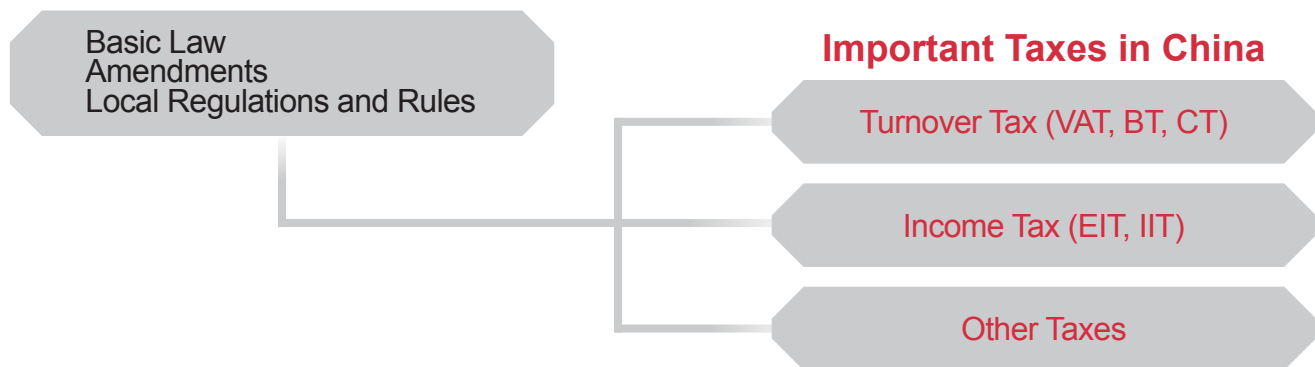
The State Administration of Taxation (SAT) is responsible for formulating and coordinating tax policies as well supervising the work of local tax bureaus which are established on provincial and municipal levels.

The Ministry of Finance (MOF) is responsible for the administration of the national budget and macroeconomic policies. Furthermore, fiscal policy and economic regulations are managed by the MOF. It also plays a key role in developing tax legislation and policy.



## 5.3 Tax Law Types

Generally the following need to be considered when dealing with tax issues:



**VAT:** Value Added Tax  
**BT:** Business Tax  
**CT:** Consumption Tax  
**EIT:** Enterprise Income Tax  
**IIT:** Individual Income Tax

## 5.4 Overview Tax Rates

| Important Taxes   | Tax Rate   |
|---|--|
| <b>Individual income tax</b> <ul style="list-style-type: none"><li>- Income on wages and salaries</li><li>- Production and business income</li><li>- Others</li></ul>   | 3% - 45%<br>5% - 35%<br>20% - 40%                            |
| <b>Enterprise income tax</b> <ul style="list-style-type: none"><li>- Income of resident enterprises</li><li>- Lower tax rate (e.g. High Technology Enterprises)</li><li>- China-sources income of foreign enterprises without establishment in China</li><li>- Income of foreign enterprises with establishment in China, income not connected with the establishment</li></ul> | 25%<br>15%<br>10% (withholding tax)<br>10% (withholding tax) |



|   |                     |
|---|---------------------|
| <b>Turnover tax</b>   |                     |
| <b>VAT</b>  |                     |
| - Sales of goods, processing..., import                                   | 17 % (basic rate),  |
| - General VAT taxpayer  | 13 % (reduced rate) |
| <b>Rates under the VAT Reform</b>   |                     |
| - Transportation Services   | 11 %                |
| - Other modern Services<br>(eg. IT, R&D, consulting)                      | 6 %                 |
| - Small tax payer   | 3 %                 |
| - Export goods  | 0 %                 |
| <b>BT</b>   |                     |
| - Depending on the scope  | 5 % (3 %, 20 %)     |
| <b>Consumption tax</b>  |                     |
| - "luxury goods" (tobacco, wines,<br>cosmetics etc.; depends on the good) | 3 % - 45 %          |
| <b>Trade tax</b>  | non-existent        |

## 5.5 Taxpayers

Taxpayers include Foreign Invested Enterprises (eg. WFOes, JVs and FIEs). Individuals that are subject to taxes in China include foreign private investors (eg. Shareholders), foreign expatriates in China and foreign independent freelancer (eg. independent engineer).

### Foreign Invested Enterprises (FIE)

- Foreign equity joint ventures
- Foreign cooperative joint ventures
- Wholly foreign owned enterprises
- Foreign-invested commercial enterprises

### Foreign Enterprises (FE)

- Permanent establishment  
(e.g. representative office)
- China sourced income  
(e.g. interest, rent, royalties etc.)

## Foreign Individuals, mainly including:

- Foreign private investors  
(e.g. shareholder of FIE)
- Foreign expatriates working in China  
(e.g. employees of FIE)
- Foreign independent freelancer  
(e.g. independent engineer)



## 5.6 Tax Catalogue

### Taxes on turnover:

- Value added tax (VAT)
- Business tax (BT)
- Consumption tax (CT)
- Customs duty on exports/ imports

### Taxes on income:

- Enterprise income tax (EIT) - *adapted for FIE, FE*
- Individual income tax (IIT) - *adapted for foreign individuals*

### Taxes on property and transactions:

- Urban real estate tax
- Vehicle and vessel usage tax
- Stamp tax
- Land value-added tax
- Contractual tax (deed tax)

### Taxes / Dues on natural resources:

- Resource tax
- Land usage due

## 5.7 Tax Registration and Declaration

### Tax registration procedures:

A company must register with local and national tax bureaus within 30 days after establishment to have its status recognized. Once the tax status is approved general VAT tax payers must register for VAT purposes with the tax bureaus. Companies not resident in China are not required to register for VAT

Note: a representative office shall apply for the tax-levying method

### Periodic tax declaration procedures:

- ☞ Monthly: VAT, BT, IIT, etc.;
- ☞ Quarterly: pre-application of EIT;
- ☞ Other taxes (e.g., land appreciation taxes, etc.) are due in the second month after a transaction

### Annual tax declaration / clearance:

- ☞ EIT: within first 5 months with audited statutory financial statement;

Late payment surcharge on delaying declaration: 0.05% per day.

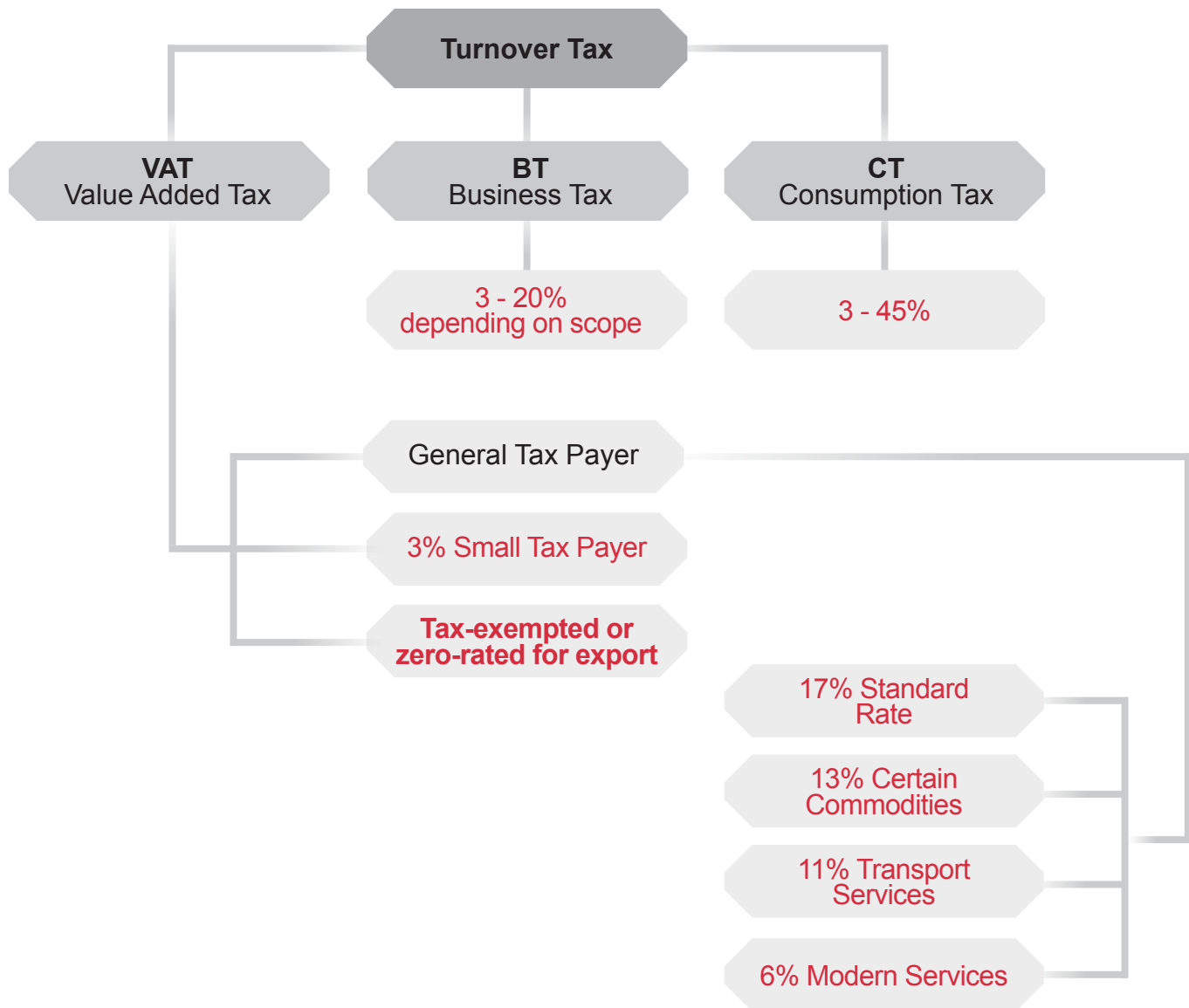
**AIC:** Administration of Industry and Commerce

**SAFE:** State Administration of Foreign Exchange





## 5.8 Taxes on Turnover



### 5.8.1 Value Added Tax

#### Scope:

- ☛ Sales and imports of goods as well the provision of processing, replacement and repair services.
- ☛ Since August 1st 2013 the following services are also subject to VAT: modern services, transportation services and leasing of tangible goods.
- ☛ There are two types of VAT payers: General VAT payers and small-scale VAT payers.

**Small scale VAT taxpayers:**

Companies with a turnover of less than RMB 5 million for provision of services or RMB 500 000 for the sale of goods are considered to be small-scale tax payers but can apply for general VAT status. For small-scale VAT payers input VAT deductions are not allowed. Instead they are subject to a VAT rate at 3% of taxable sales.

Hence, the formula for calculating the tax payable is:  $\text{sales} * 0.03$

**General VAT taxpayers:**

General tax payers can deduct input VAT from output VAT, which can lead to significant cost savings. (special “VAT invoices” needed from suppliers).




Also, being registered as a general VAT payer may increase the number of potential due to the fact that general tax payers are allowed to issue VAT receipts.

If the turnover of a company exceeds the threshold, it is mandatory to apply for the General VAT Status. However, companies below that threshold can also apply to be recognized as general VAT payer (subject to the approval of the supervising tax bureau).

Depending on the business scope there are different VAT rates for General VAT Payers.

**17%** is the standard rate. For certain goods, utilities, foods and utilities a rate of **13%** applies. Transportation services are subject to **11%** VAT and a tax rate of **6%** applies to modern services (including R&D, IT and technology services, cultural creativity services, auxiliary logistics services as well as broadcasting film & television services). Except for certain special goods, exports of goods or VAT-taxable services are either tax exempted or **zero-rated**.

**Export VAT refund:**

-  0% tax rate on output VAT
-  Input VAT credit:
  - based on refund rates
  - on materials purchased for the production of export goods is offset against the output VAT on domestic sales
-  Refund rates range from 0% to 17% for different commodities

**Note:** Registration and application for export tax refund

## 5.8.2 Business Tax

Business Tax (BT) is a turnover tax imposed on the sale of goods and services that are not covered by VAT. Some of the services that are covered by BT include: Finance, telecommunication and entertainment. Certain services are only subject to BT if the service recipient is located in China (for example construction and athletic activities).

Depending on the service scope BT rates range from 3% - 20%.

The local tax bureau collects BT and it stays with the local tax government. There are no input tax deductions available for BT.

As mentioned before, the Chinese government is in a process of replacing the entire BT system with a VAT system. The aim is to complete this transition process by 2015.

### Declaration:



Monthly

**Note:** Purchase business tax is **NOT** deductible from sale business tax or sale VAT

### BT and VAT-Reform:

To avoid double taxation for businesses the indirect tax system in China is undergoing a significant reform with the objective of gradually unifying its Business Tax (BT) and VAT system.

Under the old system supply of goods, imports of goods into China and processing/repair/replacement services were taxed at a VAT rate of 13% or 17%, while all other services were subject to business tax at rates of 3% - 20%.

The reform started out as a pilot program on 1 January 2012 in Shanghai and was further rolled out to Shanghai, Beijing, Tianjin, Jiangsu, Zhejiang, Anhui, Fujian, Hubei, and Guangdong provinces.

Since 1 August 2013 the pilot program has been expanded nationally. By 2015 the State Administration of Taxation (SAT) and the Ministry of Finance (MOF) aim to complete the nationwide transition from BT to VAT.

The relevant regulation “Circular 37” specifying the most recent changes is replacing seven previously issued regulations.



While the aim of the reform is to improve the efficiency of China's indirect tax system, the actual effects on companies affected may vary depending on the industry.

### A few interesting facts about “Circular 37” :

- ☛ The new regulations will be applied if the date when tax liabilities arise is after 1 August 2013.
- ☛ Transportation service provided from a Chinese company to a foreign company is subject to 0% VAT (originally BT).
- ☛ The VAT for international logistics can be exempted. However, each company has to apply at the tax bureau for VAT exemption.

In reality, application procedures and required documents are not very transparent in various local tax bureaus. Thus, many companies within the logistics and auxiliary services sector are reluctant to complete such procedures and shift the tax burden to the customers by charging them 6% VAT.

The threshold to be considered a general VAT tax payer has been raised to RMB 5 million (Previously RMB 500,000 and RMB 800,000 for trading or manufacturing companies respectively). A general VAT tax payer can deduct the input VAT from the output VAT. Hence the formula for calculating the tax payable is:

*Current Output VAT - Current Input VAT*

For a Small-Scale tax payer there is a much lower standard rate of 3%, irrespective of the service rendered, but input VAT cannot be deducted. Therefore the formula for calculating the tax payable is: *Sales \* 0.03*

Depending on the industry and business scope the reform can have a different impact on foreign invested enterprises.

In many cases the VAT reform can lead to tax reductions for foreign invested enterprises in China. However, the exact impacts for foreign companies inside and outside of China are often more complex and for some firms the reform can lead to tax increases. Influencing factors include tax status of the customer (General or Small-VAT tax payer), tax status of the supplier, amount of input VAT available and the VAT tax rate.

The implications of the reform can be complex and it is advisable to discuss the individual impact with a professional.

The current laws and regulations are still subject to change. Therefore the information provided might be outdated soon and should be treated with caution.

## 5.8.3 Consumption Tax

Consumption tax applies to the production, procession and import of prescribed non-essential and luxury as well as resource-intensive goods, including tobacco, alcoholic drinks, cosmetics, fuel, expensive watches, disposable wooden chopsticks, yacht, golf, jewellery, car tires, motorcycles and motorcars etc.

The tax is calculated based on the quantity or price of goods sold or in certain cases a combination of both

*E.g. the tax rate for gasoline is RMB 0.2 per liter and therefore based on the quantity. On the other hand the tax rate for cigars is 40% of the sales price.*

The proportional consumption tax rate ranges from 3% to 53% on the revenue of different types goods. Consumption tax paid on exports are fully refundable.

## 5.8.4 Enterprise Income Tax

Resident enterprises have to pay Enterprise Income Tax on their worldwide income. Foreign companies with an establishment need to pay income connected to this establishment. Foreign companies without establishment are subject to enterprise income tax on income derived from within China.

- ☛ The standard tax rate is 25%. For high and new technology enterprises the rate is 15%.
- ☛ Withholding tax rates vary depending on the country. In most cases the rate is 10% (e.g. Germany) but in some countries it might be different.
- ☛ Tax reductions are available for environmental friendly projects.



## 5.8.5 Individual Income Tax

Whether or not foreigners that are working in China are liable to pay IIT in China depends on several key factors

- ☛ Level of earning of the expat
- ☛ Duration of stay
- ☛ Payment source
- ☛ Positions the expat is holding in his host country and home country company

### Level of Income

Taxable income includes the base salary, incentive compensations like commissions and bonuses, cash allowances and contributions to an overseas insurance scheme.

The tax rate levied on that taxable income then depends on its cumulated amount. China adopts a progressive taxation system where the tax rate for freelancer's incomes progresses in three levels from 20% to 40% and the tax rate for regular employees in seven levels from 3% to 45%. A tax exemption of 4,800 RMB per month for expats and of 3,500 RMB per month for locals is granted. Furthermore, for each individual taxation category there is a quick deduction amount which will be exempted additionally for this level of taxable income.

The following table gives an overview of IIT taxation grades.

### Tax Rates for wages / salaries

| Item | Income Range     | Tax Rate | Quick Deduction |
|------|------------------|----------|-----------------|
| 1    | Less than 1,500  | 3%       | 0               |
| 2    | 1,500 – 4,500    | 10%      | 105             |
| 3    | 4,500 – 9,000    | 20%      | 555             |
| 4    | 9,000 – 35,000   | 25%      | 1005            |
| 5    | 35,000 – 55,000  | 30%      | 2755            |
| 6    | 55,000 – 80,000  | 35%      | 5505            |
| 7    | More than 80,000 | 45%      | 13505           |

**Note:** For foreigners - monthly income deduction of 4,800 RMB, tax rates valid from September 1, 2011

Thus, a quick formula to calculate the IIT burden is:

**$[(\text{Gross Monthly Taxable Income} - 4800) * \text{Tax Rate}] - \text{Quick deduction}$**   
**Duration of Stay and Payment Source**

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Furthermore, it has to be determined which part of the worldwide income the expat might receive for various assignments from various sources is deemed taxable in China. The second important factor in determining an expat's IIT liability is therefore the duration of his/her stay in China. The relevant thresholds for IIT liability are 1 day, 90 (respectively 183) days, 1 year and 5 years. In combination with the third important factor, the source of payment for the expat's income, we can then determine on which part of his/her worldwide income an expat needs to pay IIT in China.

If the expat is being paid for his assignment in China by a China company – i.e. his income is borne by a Chinese legal entity – then he/she will be liable to pay IIT from his first day on. In contrast, if the expat's China source income is borne by a Company outside of China – an overseas entity – then he/she will not be liable to pay IIT in China, unless he/she stays in China for more than 90 days. If there is a tax treaty between China and the expat's home country, this threshold is usually extended to be 183 days.



Furthermore an expat might not only have to pay IIT in China on his income derived from activities in China, but possibly also on additional income derived from outside of China. Again, IIT liability on worldwide income depends on duration of stay and source of payment for that income.

If the expat's out-of-China income is borne by a Chinese legal entity he will have to pay IIT on this income as well.



## 5-year-rule for individual income tax

Five years is an important threshold for determining expat IIT liability: an expat who is a tax resident in China for a consecutive five years will have to pay PRC IIT on his global income, no matter where it was derived and no matter by whom it is borne. That is, after five years of tax residency an expat will be taxed in China on his/her **worldwide** income. This rule should always be kept in mind, since going over the 5 years can significantly increase an expat's tax burden.

However, the 5-year-rule does not necessarily apply to every expat who would like to live in China for a prolonged period of more than 5 years. There are two possible scenarios in which IIT liability on the expat's world income could be avoided.

### Scenario 1: Before the fifth year

The first scenario is that the expat leaves China, be it for business purposes or for visiting his home country, for more than 90 days consecutively or more than 30 days for a single trip within any given year before he/she has been a tax resident for 5 years. By doing this the expat has broken tax residency and the "clock" for the 5-year-rule will be reset. For example, the expat can arrange to leave China for the necessary time period in the fifth year of his tax residency. Upon his return, tax residency will then be calculated from year one again.

### Scenario 2: After the fifth year

In the second scenario the expat might have missed the deadline for leaving China for an appropriate amount of days and has already been a tax resident for more than 5 years. Now there are two possibilities for the expat:

**(1)** For the sixth year, the expat could arrange to spend more than 90 consecutive or more than 30 days in a single trip outside of China. This would mean that the expat has broken tax residency in this year. All of his China source income will be subject to IIT, but his world income will not be. However, this measure will not "reset the clock" of the 5-year-rule and has to be repeated in the seventh and all following years.

**(2)** If in the sixth year the expat stays in China for less than 183/90 days (depending on the tax treaty between his home country and China) then tax residency is also broken. Only his/her China source income borne by a China entity will be subject to IIT. Furthermore, the "clock" of the five year rule will also be reset and this measure thus does not need to be repeated every year. In other words, if the expat manages to travel out of China for more than half/three quarters of the sixth year the five-year-rule will not be applicable and upon his return tax residency will be calculated from year one again.

## Other taxable income (e.g. freelancer)

- Income derived in the territory of China  
*such as from design, decoration, installation, law, accounting, consultancy, lecturing, etc.*
- Income below RMB 4,000: taxable income after deducting RMB 800
- Income over RMB 4,000: taxable income after deducting 20%
- Use table below

| Taxable Income          | Tax Rate | Deduction after calculation of the tax amount |
|-------------------------|----------|---|
| RMB 20,000 & less       | 20%      | 0   |
| RMB 20,001 – RMB 50,000 | 30%      | 2,000   |
| More than RMB 50,000    | 40%      | 7,000   |

## 5.9 Transfer Pricing

- Arm's length principle (e.g. market price).
- Annual declaration for affiliated transactions  
(e.g. mother and subsidiary company)
- APA advanced pricing agreement
- The tax authorities focuses more and more on the topic of transfer pricing







## 6. Mergers & Acquisitions

# 6. Mergers and Acquisitions

Purchasing a company in China can be a difficult process. However, for some companies it can be the right strategy to accelerate growth. Sometimes acquiring a Chinese company can be more effective than starting from scratch and relying on organic growth. Many advantages and disadvantages of setting up a joint venture also apply to a company acquisition.

Some of the advantages are: *access to relationships, local networks, distribution channels and local business knowledge.*

## 6.1 Approval of government agencies

Generally the Chinese government maintains an influential role in any company acquisitions. Company purchases need approval by a number of government agencies. Approvals might take considerable time and effort and depend on a variety of factors of (eg. Industry and ownership of the acquired company, investment value etc.).

Relevant Chinese government agencies might include:

- 🚩 **The Ministry of Commerce (MOFCOM)** : Responsible for overseeing and approving company purchases
- 🚩 **State Owned Assets Supervision and Administration Commission (SASAC)**: supervises and manages state-owned assets of enterprises under the supervision of the government. Purchases of state-owned companies need approval of the SASAC.
- 🚩 **State Development and Reform Commission (SDRC)**: Responsible for approving any foreign project applications.
- 🚩 **China Securities Regulatory Commission (“CSRC”)**: Responsible for regulating China’s securities and futures markets. Companies listed on China’s stock market need approval from the CSRC.

Depending on the industry sector, approval from industry- specific agencies might also be needed. This applies especially for highly regulated industries. *(e.g. the financial sector)*



## 6.2 National Security Review

In February 2011 a new rule came into effect to control purchases of domestic companies by foreign investors. Acquisitions of majority stakes in certain industries, which the Chinese government considers to be strategic (defense, infrastructure, food, technology and energy) have to be specifically reviewed by the Council of State, the Ministry of Commerce, the National Development and Reform Commission (NDRC) and other relevant agencies.

These rules are intended to control sensitive foreign investment in certain sectors that are vital to security and the Chinese economy. It is important to note that purchases of foreign invested enterprises (more than 25% is held by a foreign investor) are not subject to this review.

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## 6.3 Strategy

When elaborating an acquisition, it is recommended to design a strategy for finding suitable acquisition candidates and to develop a well defined and clear strategy for successfully integrating the business after the acquisition. When developing a strategy companies should consider:

- ⊗ Whether capital available is sufficient.
- ⊗ Whether other company resources are sufficient  
(e.g. *human resources*)
- ⊗ New regulations and possible implications for the company
- ⊗ Market size and competitors
- ⊗ Differences in culture
- ⊗ Compatibility with target company

A lack of a well-thought through acquisition strategy might result in future headaches with the target company or even failure.

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## 6.4 Acquisition Form

Generally there are two ways to acquire a company or parts of it: equity acquisition or asset acquisition. Choosing the right form depends on many factors, including tax and legal consequences, as well as the financial situation of the target company.

## 6.5 Equity Acquisition

This is the most common way to acquire a company. The foreign investor acquires equity in a Chinese company or an existing foreign invested enterprise. As mentioned before, this requires approval of different authorities. If the acquisition target is a FIE, approval has to be given by the authorities that were involved in the formation of the company. If the target is a domestic firm it will need to be converted into a foreign invested enterprise and the relevant authorities need to approve it.

Purchasing equity is often the fastest and most convenient way to acquire a company. However, it is important to note that, in an equity acquisition, the purchasing company also “acquires” the rights and liabilities of the target. Should the target company have a lot of debts or other liabilities it could be exposed to high risks.

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## 6.6 Asset Acquisition

An alternative way is to acquire selected assets of the target company. This enables the foreign investor to “cherry- pick” the best assets. There is no change of equity ownership. The acquiring company merely buys certain parts of the target company and there is no government approval needed for the transfer of assets. However, in order to purchase any assets in China, an FIE has to be established, which requires approval of many government agencies.

Generally this method is more time consuming but the advantage is that liabilities of the target companies are not assumed, which can lower the risks associated with an acquisition considerably. However, as opposed to an equity acquisition, all business and employment contracts related to the assets acquired need to be renegotiated and signed by the buyer, which can be very time consuming. Furthermore, the seller will have to pay higher taxes which might be passed on to the buyer.

Also, if the target company is an FIE and sells all its assets, money saved from preferential tax treatments can be claimed back from the government if the conditions for receiving the incentive in the first place have changed.

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## 6.7 Debt Funding of an Acquisition

Foreign investors considering to finance an acquisition with loans should be aware of the debt-to-equity regulations for companies in China.

## 7. Due Diligence



## 7. Due Diligence

When purchasing a Chinese company or considering a joint venture a thorough due diligence investigation of the target company should be carried out. This is usually done in a discreet manner to anonymously check the target prior to any engagements.

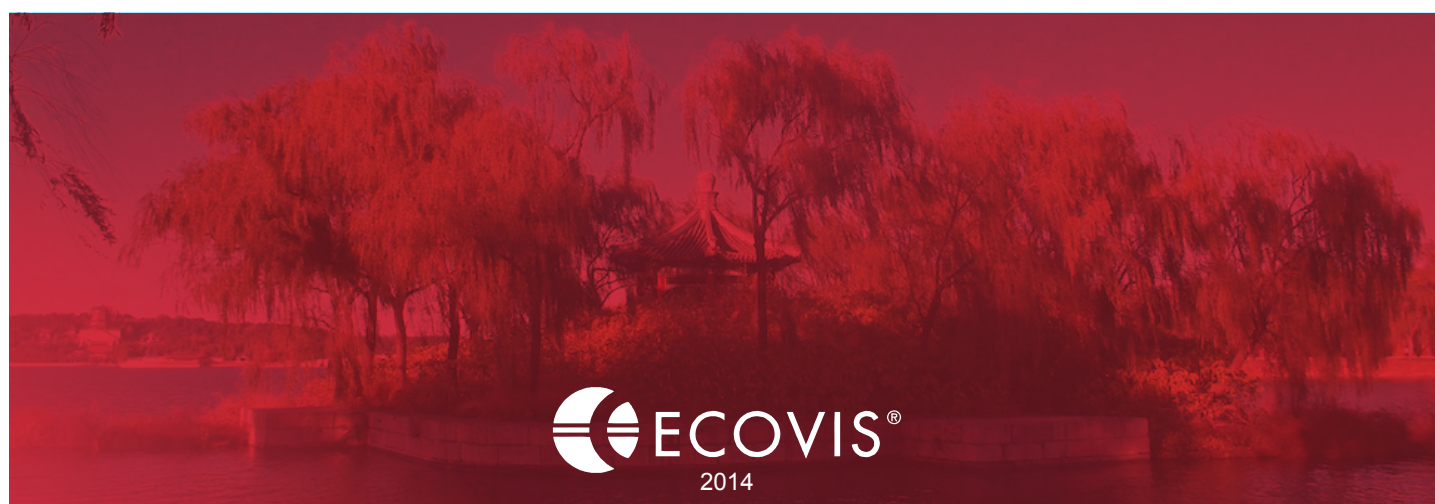
Unfortunately it is not uncommon for certain information to be hidden or changed by the target company. Therefore the importance of carrying out a thorough due diligence investigation should not be underestimated. There are different types of due diligence checks, which will be explained further:

For simple trading purposes a basic due diligence check, called credit and background check is often sufficient.

In case of an acquisition or merger, a more thorough analysis should be conducted to minimize any risks.

One important aspect of a thorough due diligence check is to figure out if the target company has been founded correctly. The following documents should be checked:

- ☞ Shareholders' agreement
- ☞ Business license
- ☞ Additional licenses and permits if existent
- ☞ Articles of association
- ☞ Bank reference letter
- ☞ Certificates of ownership
- ☞ Tax statements
- ☞ Leasing & renting contracts
- ☞ Contracts with main clients



## 7.1 Common Issues

During a due diligence check, issues might be encountered in the following areas:

- ⌘ Business transaction records are incomplete or not compliant with accounting standards (Chinese or international)
- ⌘ Tax payments are incomplete/ not properly recorded/ not compliant.
- ⌘ Outstanding tax liabilities are unclear/not listed properly
- ⌘ Legal agreements and employment records are incomplete or not properly recorded
- ⌘ Data measuring operational and financial performance is incomplete, which makes it hard to conduct a business analysis
- ⌘ No proof of ownership for certain assets  
(e.g. *Intellectual property and land-use rights*)
- ⌘ Incorrect transfer pricing
- ⌘ Multiple data for financial and operational results. Sometimes companies keep different books, depending on the purpose. A book kept for potential investors might show exceptional figures and business development curves, while a book for tax authorities might show the opposite to save taxes. The truth might be somewhere inbetween.
- ⌘ Contingent liabilities



Chinese companies might be less experienced in documenting operational and financial documentation properly. Therefore it is not unusual to encounter any of the issues mentioned above.

A due diligence check might also reveal management or other fundamental problems. Although these issues are more common in private companies, they might also occur in state-owned firms.

To conduct a thorough due diligence check and make a detailed assessment of all the potential risks it is strongly recommended to seek a professional advisor.



## 7.2 Compliance with Environmental Regulations

As mentioned before, one goal stated in the current five-year plan is environmental protection. Therefore companies need to fulfill environmental regulations. Failure to do so might result in severe penalties. It should be noted that aside of the party causing the damage, the person/company using polluted assets can also be made liable.

For example, a foreign investor might be held partially liable if a factory is built on a previously polluted ground. Even if another party has caused the pollution. Generally either the asset owner or the causing party is liable for environmental damages. Investors need to be aware of this liability risk and subsequently a thorough due diligence check should be carried out.

It is also advisable to include a non-liability clause in the contract before acquiring any assets that might be exposed to liabilities associated with pollution.







# 8. Human Resource Management

In the Chinese labour market, demand for qualified and talented workers outweighs supply. Although there is a steadily increasing number of Chinese university students, graduates are often unsuitable for positions in foreign firms due to a lack of working experience, English skills and soft skills. The resulting labour shortage can pose problems for foreign firms entering the Chinese market. Besides a lack of skilled workers, there is also a high employee turnover rate. Therefore the challenge for foreign companies is not only to find talented employees but also to retain them.

Finding and maintaining key talents is one of the main issues that foreign investors are facing in China. Strategies for attracting and keeping employees that have been successful outside of China might not yield results within China. Hence it is important to develop a human resource strategy that takes cultural differences into consideration.

Especially for larger companies, it is an advantage to develop a brand as an employer, which should promote the unique selling points to potential employees and reflect the company's business culture.



The values behind the brand need to be promoted internally and externally. Key talents have various employment options. Designing a clear employment brand can be a competitive advantage when competing with other firms for skilled employees.



## 8.1 Staff Recruitment Process

Contrary to what foreign firms might be used to, it is common, even for SMEs, to be overloaded with applications for every position advertised. It is a widespread practice for Chinese applicants to send tons of generally formulated applications to different positions at numerous companies.

Filtering out suitable candidates and verifying information from applicants can be very difficult, specifically for SMEs, which are not used to such a high volume of applications.

After pre-selecting candidates that might be suitable, it is recommended for SMEs to have a short telephone interview to test the candidates' English skills. Given steadily increasing salary expectations, it might also be useful to ask for the anticipated wage. This is a common question in China and can help to select fitting personnel. However, it should be noted that compensation data from previous employments is often exaggerated.

If a SME experiences problems to manage the high number of applications, introducing an online recruitment system, which is already used by many larger companies in Europe and the US, might be beneficial. There are various companies, which specialize in this field and can be consulted for further help.

## 8.2 Personal Interview

In a personal interview the candidate should be treated with similar respect as a business partner. He/she should not wait unnecessarily long. Also, as a sign of courtesy it is common to hand the candidate a business card with both hands (as explained before) and offer a drink. Given the shortage of talents, in many cases the purpose of a personal interview should not only be to get to know the candidate better but also to advertise the position to the candidate. High qualified individuals often have many offers and need to be convinced first.

To be able to successfully hire the most prospective executives, candidate's wants and needs need to be taken into consideration. Looking at the interview through the eyes of the candidate can help hiring managers to offer a more attractive opportunity to each candidate. Growth opportunities in a company, social benefits as well as less tangible factors such as working atmosphere can be more important for employees than compensation packages and should be taken into account.

An interview can include fairly similar questions as in Europe or the US. It is advisable to ask a candidate for the reasons of leaving former employers and to look at the frequency of job changes.

This can be an indicator of how long the executive candidate is likely to stay.





## 8.3 Hiring Employees from Abroad

For certain positions companies might be more comfortable to hire expatriates. Sometimes talents are simply imported due to a lack of suitable candidates in China. Either way, the number of foreign professionals coming to China from all over the world is continuously rising and in larger firms exchange programs, in which employees stay temporary in China are more and more popular.

Employing expatriates can have advantages and disadvantages.

### **Advantages include:**

- Knowledge of the organisation, its culture and how it functions, especially how the job function fits into the company as a whole. Obviously this only applies to more experienced individuals. However, even younger employees usually understand the company culture better than a Chinese person due to cultural differences.
- Education level and management skill set might be more suitable to the needs of Western companies. Especially in terms of soft skills, expatriates often have an advantage over Chinese employees.

### **Disadvantages include:**

- Hiring expats costs considerably more. The salary of a locally hired manager might amount to only 20% of the wage of an expat in a similar position.
- Very few expats have sufficient Chinese language capabilities to manage operations in Chinese. Therefore often they rely on help of local employees.
- Expats often have a lack of understanding of the Chinese culture. This makes it more difficult to communicate with Chinese employees as well as business partners and it makes it difficult to develop business relationships, which are crucial for success in China.

Workers, who often possess a unique skill set are Chinese native speakers, who have studied and potentially worked and lived in worked and lived abroad for a longer period. These individuals might be more likely to understand both cultures and are fluent in English and Chinese. At the same time they are often demanding lower compensation packages than their European or American counterparts.

## 8.4 Labour Law

China's labor law of 1994 provided a basic framework for employers and employees relationships. However the experience has shown that these rules are poorly enforced, particularly in rural areas.

## 8.5 New Labour Law

On June 29, 2007 the Labor Contract Law of the PRC was adopted and came into effect January 1, 2008. The aim of the new law is to improve the employment relationship, clarify rights and obligations of employees and employers. Some regulations will be described as follows.

### 8.5.1 Employer's Liabilities

Employers are liable for damages caused by invalid contracts, lack of mandatory minimum content in labor contracts, violating laws by company rules or failure to issue termination certificates.



### 8.5.2 Written Contract

The contract has to be in writing. A written contract must be signed by both parties to establish the employment relationship. If the employer fails to enter into a written contract with an employee for more than one month but less than 12 months, the employer shall pay the employee twice the salary for every month without a written contract. If there is no written contract for more than 12 months the contract is seen to be an open-ended contract

## 8.5.3 Probation Period

The parties can agree on only one probation period that cannot be extended. The law requires employers to pay their employees at least 80 percent of their contractual salaries. This amount cannot be below the minimum wage. The maximum probation period is based on the term of the contract. In the case the employer fails to comply with the statutory probation periods, the compensation following the salary standard applicable to the employee after the probation period has to be paid.

### Tax Rates for wages / salaries

| Working Period   | Probation Period      |
|------------------|-----------------------|
| < 3 months       | No probation period   |
| 3 months- 1 year | A maximum of 1 month  |
| 1 year- 2 years  | A maximum of 2 months |
| 2- 3 years       | A maximum of 3 months |
| >3 years         | A maximum of 6 months |

## 8.5.4 Payment of Wages

An employer is obliged to pay salary, in accordance with the national regulations of the employment contract, on time and in full.

## 8.5.5 Staffing agencies

The new law affects representative offices which use the service of FESCO or other HR agencies. A company using staffing agencies services will have to pay overtime and performance based bonuses and benefits, and apply the same pay standard and pay increase mechanism for all employees. The agent and the company are both jointly and severally liable for each breach of contract.

## 8.5.6 Non Competition Agreement

Non competition clauses are only legally effective if they are concerning higher management personnel, leading engineers or employees with access to classified information.

A non competition-clause is valid for a maximum of two years. During this time period, the employee is not allowed to work for competitors or to set up a competing company. To maintain the non-competition clause the employer has to pay the employee an adequate monthly compensation. It is recommended to ask the local authorities for further information.

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### 8.5.7 Employee Dismissal

An employee can – apart from the probation period - terminate his/her employment with a cancellation period of 30 days.

The employer can - apart from the probation period- only dismiss the employee if the employment contract expires or the employee seriously violates the terms of the contract. A cancellation period of 30 days applies. Reasons for dismissal are strictly regulated by law. Generally it is often difficult to dismiss employees, whose contract has not expired.

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## 8.6 Employee Handbook

According to the Chinese labour laws every company is required to have an employee handbook (in accordance with the law) to ensure employment rights of the employees and specify their employment obligations. Rules and regulations that are stipulated in the employee handbook are considered legally binding in legal disputes courts.

An employee handbook is important to:

- ☞ Clearly set out the framework for a company to govern its employee relations.
- ☞ Prevent possible misunderstandings with employees.
- ☞ Have written evidence in labor disputes.

Often companies don't make the employee hand book detailed enough. This can result in negative consequences for the employer. For instance: If an employee is suing the company for wrongful termination and the employer cannot prove that the employee was informed in the employee handbook that the behavior that led to his/her dismissal was prohibited, the employee is likely to win the lawsuit which could be costly for the company.

Therefore, drafting an effective employee handbook is very important and it is recommended to consult a legal expert for help. Ecovis China can help your company to create a comprehensive employee handbook.





# Useful Links on the Internet



## Chinese Government Bodies:

-  State Administration of Taxation (English & Chinese)  
<http://www.chinatax.gov.cn>
-  People's Republic of China General Customs Administration (Chinese)  
<http://www.customs.gov.cn>
-  People's Republic of China State Administration of Foreign Exchange SAFE (English & Chinese)  
<http://www.safe.gov.cn>
-  Ministry of Commerce MOFCOM (English, German & Chinese)  
<http://www.mofcom.gov.cn>


## Chinese Chambers of Commerce and Business Councils:

-  The German Chamber of Commerce in China (English & Chinese)  
<http://china.ahk.de>
-  The European Chamber of Commerce in China (English & Chinese)  
<http://www.euccc.com.cn>

## Accounting and Auditing in China:

-  Chinese Institute of Certified Public Accountants (Chinese)  
<http://www.cicpa.org.cn>
-  Shanghai Institute of Certified Public Accountants (Chinese)  
<http://www.shcpa.org.cn>





## Local Business Environment in China:

-  Shanghai Taxation Bureau (Chinese)  
<http://www.csj.sh.gov.cn>



# Support by your ECOVIS-Advisor

If you have questions left the tax advisers, accountants, lawyers and auditors of ECOVIS would be very happy to support you with our services in the areas of:

-  Tax
-  Audit
-  Accounting
-  Legal

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[www.ecovis.com/china](http://www.ecovis.com/china)