

Break Through the Chinese Wall

**- Legal and practical guidelines
for establishing a company in China**

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About the book

“Break Through the Chinese Wall” is an accessible handbook which provides an introduction to the fundamental rules, regulations and common practices related to establishing and running a business in China. The handbook provides answers to the most frequently asked questions from our clients.

The handbook has been jointly written by Capital Associates and NCO China. Capital Associates is a Chinese law firm specialised in providing commercial legal services and assistance to foreign companies investing in and trading with China. NCO China is a consulting firm that offers corporate services with regard to the establishment of an enterprise in China, Hong Kong etc., and provides accounting, tax and HR services to foreign investors in China. Both Capital Associates and NCO China serve a variety of clients; from large multinational companies to small and medium sized enterprises.

China’s rapid development means that regulations and practices are constantly changing. The handbook is meant to be an introduction to the current laws and practices in China. Updates and further information regarding the subjects covered by the handbook can be obtained from our offices or websites. Please refer to the contact information in the back of the book.

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Choosing the right location in China

Unless the location of a Foreign Investment Entity (FIE) is known in advance, a foreign investor should carry out comparative analyses of potential locations for operation before deciding on the right place to set up a FIE.

In China, conditions vary considerably from one part of the country to another, including factors such as climate, infrastructure, local government support, availability of natural resources and energy, and educational level of the local workforce. The right place for one type of enterprise may not be the right place for another type.

Geography

China has a landmass of 9,600,000 sq km, making it roughly the same size as continental United States. The country stretches from the tropical and subtropical zones in the south to the frigid zones in the north. Cultivated land, forests, grasslands, deserts and mountains cover most of the western part of the country, making the eastern part and the coastal zone the most accessible places for economic development and foreign investment.

Development zones

Since China implemented the gradual opening-up policies in 1978, most major cities in Eastern China, including the surrounding rural areas, have been developed in order to attract foreign investments. With Beijing, Shanghai, Shenzhen and Guangzhou taking the lead, these places offer various advantages such as good infrastructure, modern business facilities, skilled employees, etc.

Economic development in China has been encouraged by the establishment of various development zones such as Economical Development Zones, Economical and Technological Development Zones, Hi-Tech Industrial Development Zones, Free Trade Zones and Export Processing Zones. The purpose of these zones is to attract foreign investments and to direct them to designated areas.

Development zones are relatively small pieces of land traditionally situated in many coastal cities and other open cities in the eastern and southeastern part of China. Taking advantage of the many preferential policies such as reduced taxes, exemption from customs duties and minimized administrative burdens, foreigners investing in manufacturing, export of goods, research & development, etc., often choose to set up their businesses in development zones.

Since 2000, the Chinese government has stepped up efforts to spread economic growth by including cities and regions in the central and western parts of China to the list of development zones. The government has also encouraged foreign investments in key-sectors such as resource development, conversion of arable land back into forests and grassland, processing of plant and animal products, development of local industry and liberalization of social services.

You can learn more about China's development zones by visiting the official website: www.fdi.gov.cn

Choosing the right location

The below methods may be helpful in choosing the right location in China:

- Define your set selection requirements e.g. utility and transportation needs, access to raw materials and skilled workforce, etc.

- Select locations that are suitable for your needs and visit them. Build up personal networks and gather information from these local areas.
- Find out if you can take advantage of preferential policies in development zones.
- Evaluate options and preferential policies offered by local governments.
- Find out whether you can enjoy local tax incentives.

Frequently Asked Questions

1. Is Shanghai or Beijing preferred for setting up a Representative Office (RO)?

Beijing and Shanghai are often chosen as locations for Representative Offices because of their status and role in China's economic development. These cities have developed significantly in recent years and both offer excellent business facilities and living conditions for foreigners.

Beijing:

As the nation's capital, Beijing is home to central government offices and agencies responsible for obtaining business approvals and licenses. In Beijing, you can also find foreign embassies and other political and non-political representations.

Generally speaking, government plays an important role in China and has greater influence on business than in western countries. It is important for foreign companies to understand and follow state policies as well as liaise with relevant government authorities and agencies, especially for industries where the

government plays an influential role, such as the wind energy industry. As a result, most medium and large sized companies have a government relations department. Being in close proximity to government authorities and agencies is often the main reason why many foreign investment companies choose to set up their headquarters in Beijing.

Shanghai:

Shanghai is the financial centre and China's most modern city. With world-class infrastructure, Shanghai is easily reached from all over the world. Most foreign governments have representations in the form of consulates in Shanghai. Local government agencies in Shanghai have the reputation of being more efficient and service-minded than in Beijing. Shanghai authorities are also said to provide better treatment to large foreign companies by offering them tax incentives and other advantages.

However, the costs of setting up a business in Beijing or Shanghai are among the highest in China. It may, therefore, be more ideal for small and medium sized enterprises to establish production facilities in areas near Shanghai, Beijing or Guangzhou, where costs are lower, but they still have access to a reasonable investment environment and qualified employees.

The choice of location is important, and in some cases, may determine the success or failure of the foreign investment.

2. *Is it possible to purchase land in China?*

Despite economic and political reforms in China, the Chinese government has not yet given up the established socialist idea of state ownership of land. In China, individuals or private legal persons cannot own land; land is either collectively owned (rural areas) or state-owned (urban areas).

If you need a site for your production facilities in China, you will have to apply to the local authorities to acquire the necessary land-use rights. Always make sure that the conditions under which you are granted land-use rights meet your specific requirements in terms of period of usage, scope of application, renewal conditions, etc.

When acquiring land-use rights you need to distinguish between allocated land-use rights and granted land-use rights.

Allocated land-use rights are often allocated from the Chinese government for specific investment projects free of charge. Usually, the right is not transferable, and the land cannot be leased or mortgaged. The holder of an allocated land-use right is required to pay a land-use tax on an annual basis.

Granted land-use rights can be acquired by paying a land-grant fee to the Chinese government. The fee varies significantly depending on the market value and location. Within the fixed term of the land-use right, the holder has the right of use similar to that of an owner. The land is transferable and it can be leased and mortgaged.

3. *As regards setting up production facilities in China, what are the main differences between urban and coastal areas as opposed to rural areas?*

Pros urban and coastal areas:

- Large amount of skilled and educated employees.
- Easy to find suppliers, spare parts, service providers, etc.
- Good infrastructure and logistics with an easy access to airports and harbours.

- Less administration and paper work with local governments, as they are experienced in handling foreign investments.
- Living conditions are comfortable for expatriates.

Cons urban and coastal areas:

- Business and living costs are considerably higher compared to more remote places in China.
- Lack of electricity can be a problem in certain areas because of excessive demand.
- Staff retention may be difficult due to many job opportunities.
- Difficult to negotiate special terms for business start up.

Pros rural areas:

- Possible to negotiate good terms and conditions for the business start up as foreign investments are rare and highly welcomed.
- Business and living costs are lower.
- Good access to raw materials.
- Fewer problems with electricity supply.
- Easy to make a difference in the local community.

Cons rural areas:

- Lack of skilled and educated employees.
- More paper work and time spent with local governments must be expected.
- Infrastructure and logistics may be underdeveloped.
- Little experience with foreigners' requirements and needs.
- Very difficult for expatriates to accept the living conditions.

4. *Where are Chinese free trade zones located?*

Like free trade zones in other parts of the world, Chinese free trade zones are specialized areas for international trade and bonded operations in which international trade, bonded warehouses and processing for re-export are allowed.

China has around 15 free trade zones situated in the coastal regions from Dalian in the north to Zhuhai and Haikou in the south.

5. *Where are Chinese export processing zones located?*

Like export processing zones in other parts of the world, Chinese export processing zones are special enclosed areas supervised by customs and reserved for export-oriented enterprises. The zones are operated under a separate legal regime granting exemptions from customs import and export duties and value-added tax.

China has around 58 export processing zones in operation mainly situated along the coast from Huichun in the north to Shenzhen in the south. Chengdu and Wuhan in the Sichuan and Hubei Provinces are inland export processing zones.

Useful links

Help and advice when establishing a FIE in China

- www.capitallaw.cc
Capital Associates' website.
- www.ncochina.com
NCO China's website.

Government and organizations

- <http://english.gov.cn/index.htm>
The official website of the Chinese central government.
- www.ebeijing.gov.cn
Official website of the Beijing Municipal Government.
- www.shanghai.gov.cn
Official website of the Shanghai Municipal People's Government.
- www.china.org.cn
Government portal site to China that offers broad access to news about China.
- www.fdi.gov.cn
Website of the Chinese Ministry of Commerce directed to foreign investors. The site comprises government news and information about investment directions, economy, statistics and law.
- <http://english.mofcom.gov.cn/>
Official website of the Chinese Ministry of Commerce.

- www.chinainvest.com.cn
China International Electronic Commerce Centre's website. Contains investment news and information about investment projects in China.
- www.tdctrade.com
Hong Kong Trade Development Council's website. Provides information about CEPA.
- www.tid.gov.hk/english/cepa/
Website of Hong Kong Trade and Industry Department. Provides full text documents on all CEPA agreements and annexes.
- www.adb.org
Website of the Asian Development Bank.

Other sources of information about China

- www.transparency.org
Website of Transparency International, a coalition against corruption.
- www.hoover.org/publications/clm
Website of the Hoover Institution of Stanford University. Provides information about China's leadership politics and its foreign and domestic policies.
- www.chinaeconomicreview.com
China Economic Review is a monthly magazine published in Hong Kong covering business, finance and economics in China.
- www.worldbank.org/transitionnewsletter
World Bank newsletters on developing economies.

- www.cia.gov/library/publications/the-world-factbook/
U.S. CIA World fact book.
- www.expatsinchina.com
A guide for foreigners living in China.

Logistics

- www.maps-of-china.com
Maps of Chinese cities, provinces and regions in the principal areas of China.
- www.primecargo.com
Website of the international transportation and freight forwarding company Primecargo.
- www.dsv.com
A transportation company that offers end-to-end transport and logistics solutions.

News in English

- www.chinadaily.cn
Website of China Daily, the Chinese government's official mouthpiece.
- www.scmp.com
Website of South China Morning Post, which is a little less censored than China Daily.
- www.shanghaidaily.com
Website of the local Shanghai newspaper
- <http://english.peopledaily.com.cn>.

Chambers of commerce

- www.amcham-china.org.cn
The American Chamber of Commerce in China.
- www.europeanchamber.com.cn
The European Chamber of Commerce in China.
- www.pek.britcham.org
The British Chamber of Commerce in China.
- www.ccifc.org/
The French Chamber of Commerce in China.
- www.dccc.com.cn
The Danish Chamber of Commerce in China.
- www.swedishchamber.com.cn
The Swedish Chamber of Commerce in China.

Abbreviations

AIC	Administration of Industry and Commerce
AMEA	Anti-Monopoly Law Enforcement Agency
ASBE	Accounting Standards for Business Enterprises
BLTB	Beijing Local Tax Bureau
CAS	Chinese Accounting Standards
CBRC	China Banking Regulatory Commission
CCPIT	China Council for the Promotion of International Trade
CEPA	Closer Economic Partnership Arrangement
CIETAC	China International Economic and Trade Arbitration Commission
CJV	Contractual or Cooperative Joint Venture
CO (CEPA)	Certificate of Hong Kong Origin (CEPA)
COFCOM	Commission of Commerce
CPA	Certified Public Accountant
CSRC	China Securities Regulatory Commission
DTT	Double Taxation Treaty
EJV	Equity Joint Venture
EPZ	Export Processing Zones
FESCO	Foreign Enterprise Service Corporation
FIE	Foreign Investment Entity
FIP	Foreign Invested Partnership
FR	Factory Registration with TID (CEPA)
HKTDC	Hong Kong Trade Development Council
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LoI	Letter of Intent
MII	Ministry of Information Industries
MOFCOM	Ministry of Commerce
MOLSS	Ministry of Labour and Social Security
NDRC	National Development and Reform Commission
NPC	National People's Congress

PBOC	People's Bank of China
PRC	People's Republic of China
RMB	Renminbi
RO	Representative Office
ROOs	Rules of Origin (CEPA)
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce
SAR	Special Administrative Region (Hong Kong and Macau)
SAT	State Administration for Taxation
SIPO	State Intellectual Property Office of the PRC
TID	Hong Kong Trade and Industry Department
TRIPs	Trade-Related Aspects of Intellectual Property Rights (agreement under WTO)
WFOE	Wholly Foreign Owned Enterprise
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

References

We have found inspiration for the handbook on the websites listed under “Useful links”. In addition, various materials from events and presentations together with “Danmarks Nationalbank, Quarterly Review 1, 2009” have been used.

Last, but not least, we have drawn on the long experience of Capital Associates and NCO China in advising clients.

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