

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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Foreign currency restrictions in China

Since July 2008, China has adopted a fixed exchange rate policy against the US Dollar. The policy maintains a stable RMB against a basket of currencies, but in practice there are only US dollars in the basket. China's central bank, the People's Bank of China (PBOC), uses two tools to keep the RMB stable: Traditional intervention in the currency market and foreign currency restrictions.

The RMB exchange rate against the world's major foreign currencies is published daily by PBOC via the China Foreign Exchange Trading System. Banks can trade foreign currencies within the bands determined by PBOC.

Since China is the world's largest exporting country and one of the largest receivers of foreign direct investments, there are many cross border transactions in and out of the country. Currency restrictions are imposed on both inward and outward transactions which makes getting money in and out of China cumbersome.

The financial sector

The financial sector in China is dominated by the banking sector, where the biggest banks are state-owned. The bond and stock market is still relatively undeveloped.

Chinese banks are subject to restrictions from the PBOC on the rates they can charge when they lend money. They cannot charge a higher interest rate to compensate for higher credit risk. This means that state-owned enterprises usually have easier access to financing than small and medium sized enterprises and foreign companies.

Although the Chinese government recognize the problems in the financial sector and have, to some extent, liberalized the sector, the

government is still reluctant to initiate further liberalizations. State ownership is considered the most effective way to maintain control of economic development.

The integration of China's financial market with the international financial market, and financing abroad in the form of bank borrowing or securities, is still limited. Financing from a Chinese bank or the foreign parent company is not prevalent either. Therefore, when setting up a Chinese enterprise, it is important to have sufficient capital to meet the enterprise's expected operating and development costs. For more information on the relevant regulations and specific recommendations on how to handle the financing of a new FIE please refer to the chapter "Establishing an enterprise in China".

Foreign currency certificate

When a FIE has been registered and received its business license, the company must apply for a foreign currency certificate (IC card of Foreign Exchange Registration Certificate) from the State Administration of Foreign Exchange (SAFE). The certificate makes it possible for the company to open a currency bank account to convert foreign currency to RMB and vice versa.

The currency certificate is valid for one year, after which the certificate must be approved again to be renewed. It is therefore important that the FIE continually fulfills its obligations in regard to the foreign currency management.

Bank accounts and payments

FIEs may only deposit RMB and foreign currencies in banks that are approved to handle foreign currencies; i.e. banks that have a foreign currency account with the central bank. Most large banks have foreign currency accounts. Due to the bank's obligation to monitor

foreign currencies transactions made by FIEs, all transactions involving foreign currencies must take place from these accounts. The banks must continually report their clients' holdings of foreign currencies, and whether the clients follow procedures (information on type of goods, quantity and amount) applicable to the receipt of foreign currencies when exporting and the payment of foreign currencies when importing.

Given currency restrictions in China, foreign currencies cannot be used as the currency for payment in China. A FIE is obliged to open a currency account to hold its foreign currencies (capital account) and a RMB account to be used for daily operational payments (operating account).

The capital account and the operating account are subject to different regulations.

The capital account is used to deposit investment capital, i.e. the investment capital required for start-up, loans and/or equity increase. In contrast to the operating accounts, capital accounts are subject to a numbers of restrictions. During the approval process, the authorities go in depth into the substance of the application, including the future usage of the capital.

The operating account can only be used for payments related to ordinary business transactions, including salaries and payments from the sale and purchase of goods and services. Opening an operating account is not subject to many restrictions, but it can be administratively tedious. Approval is normally achieved, but it can be a slow and painful process.

For a foreign investor in China, there are a number of issues that should be considered before the FIE can start operating:

- The enterprise's local bank must be approved to handle foreign currency.

- It is necessary to open a number of bank accounts (both capital accounts and RMB accounts for ongoing operations and financial purposes).
- China's currency restrictions mean that cross border transfers (e.g. increase in equity investment or transfer of the surplus of the Chinese company to the parent company) is an administrative process that requires both approval and involvement of Chinese authorities.

Frequently Asked Questions

1. *Should the invested capital for a FIE be paid in foreign currency or RMB?*

Given Chinese currency restrictions, it is only possible to bring in foreign currency (USD, JPY, GBP, EUR, KRW, CHF, AUD or CAD), which is subsequently exchanged into RMB. The currency amount shall be consistent with what is stated on the business license.

2. *Can a FIE get a currency loan from a foreign bank?*

Yes, but the bank must be approved by SAFE to handle foreign currency, and the loan must be reported to SAFE. Regulations for the transfer of foreign currency to China must be followed.

3. *Can a foreign company borrow RMB from a Chinese bank?*

In principle, yes, however, in practice it is difficult. Chinese banks prefer to lend to large Chinese (often state-owned) enterprises, where the credit risk is considered lower compared to foreign companies with whom Chinese banks are less familiar. The

banks are subject to restrictions from PBOC with respect to the rates they can charge on their loans, and cannot charge a higher rate to cover the higher credit risk. Collateral for loans is not widely used in China. Therefore credit risk can only be brought down to a limited extent. If a FIE needs to bring in additional capital, the best solution is to apply for an increase in the company's equity.

4. *Can a FIE obtain an overdraft facility from a Chinese bank based on a guaranty from a foreign bank?*

In principle, yes, however, in practice it is difficult for the same reasons stated above in question 3.

5. *Is it difficult to get foreign currency into China?*

No, it is not difficult, but it can be an administrative burdensome process.

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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