Establishing WFOE in the PRC

Corporate Vehicles in the PRC

The following are five legal corporate vehicles used in the People's Republic of China ("PRC"):-

Types	Business Scope	Limitation
Domestic Company	All businesses	Only available for Chinese residents
Joint Venture ("JV")	Most businesses and open up some business restricted to foreign investors*	Chinese investors are generally the majority shareholder with significant control over the JV Have additional reporting and limitation on the usage of foreign capital^
Wholly Foreign-Owned Enterprise ("WFOE")	All business allowed under Foreign Investment Catalogue*	Have additional reporting and limitation on the usage of capital^
Branch	Restricted to principal entity's business scope	Have financial and legal impact to the principal company
Representative Office	Liaison only	No legal status and generally cannot enter contracts

^ Entities need to report to and get approval from the State Foreign Exchange Administration each time on the usage of foreign capital
** The Foreign Investment Industry Guidance Catalogue classifies foreign direct investment in various business activities as encouraged, restricted, or prohibited. Activities not listed are permitted. Foreigners cannot participate into prohibited business and on conditions to restricted business.*

Each corporate vehicle offers certain advantages and drawbacks. Investors may choose the option that best suits their development goals and capabilities. Since acquiring existing PRC domestic companies can be complex and time consuming, foreign investors generally seek to incorporate their own new corporate vehicles. In recent years, WFOE has been the popular vehicle and almost 80% of the PRC foreign investments are in the form of WFOE.

What is WFOE?

WFOE, a limited liability company, is commonly used corporate vehicle to carry out investments by foreign investors. It is 100% owned by one or more foreign investors. The main attractions are that WFOE takes shorter time to establish than a JV; not required to have local partners; or negotiate JV contracts. WFOE also does not need a principal entity as required under Branch and Representative Office structure.

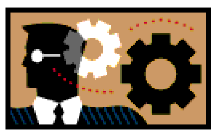
WFOE is generally a desirable corporate vehicle for foreign investors as it provides full control over the operations and investments. The distinctive legal status also allows WFOE to enter into contracts with different business parties without general limitations.

What Multi-National Corporations Do?

The PRC welcomes foreign investment and it is bound under the WTO rules to further open its market to foreign investors. A number of special economic zones, economic and technological development zones, export processing zones and bonded warehouse zones are being setup to attract foreign investments. Various preferential policies covering tax, foreign exchange, custom, investment, employment, etc. are provided to qualified foreign investments in these zones. In order to capture these benefits and opportunities, presence in these zones is necessary.

For the above reason, multi-national corporations usually incorporate WFOE as a holding vehicle to own their PRC investments and operations in the above-mentioned zones. Such WFOE offers certain economies of scale in operation and management through the collection of investments under one corporate identity. These include centralize procurement, training, marketing, promotions, and project coordination in the PRC.

Using **WFOE** as a central coordination for all investments and business activities in the PRC



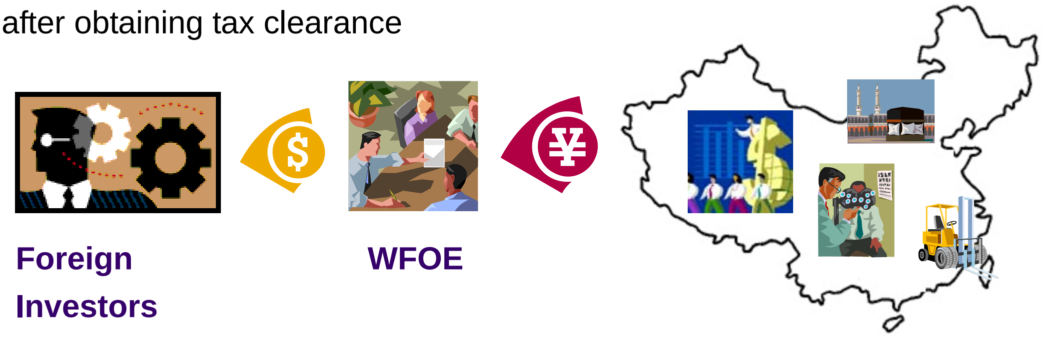
Foreign Investors with skills and knowledge

Investment repatriation

WFOE may on its own discretion distribute / repatriate partly or all of the distributable retained profits in the form of dividend after withholding tax. In addition, WFOE may utilize the Double Tax Agreement's entitlements entered into between the PRC and different jurisdictions to enjoy a reduced withholding tax rate.

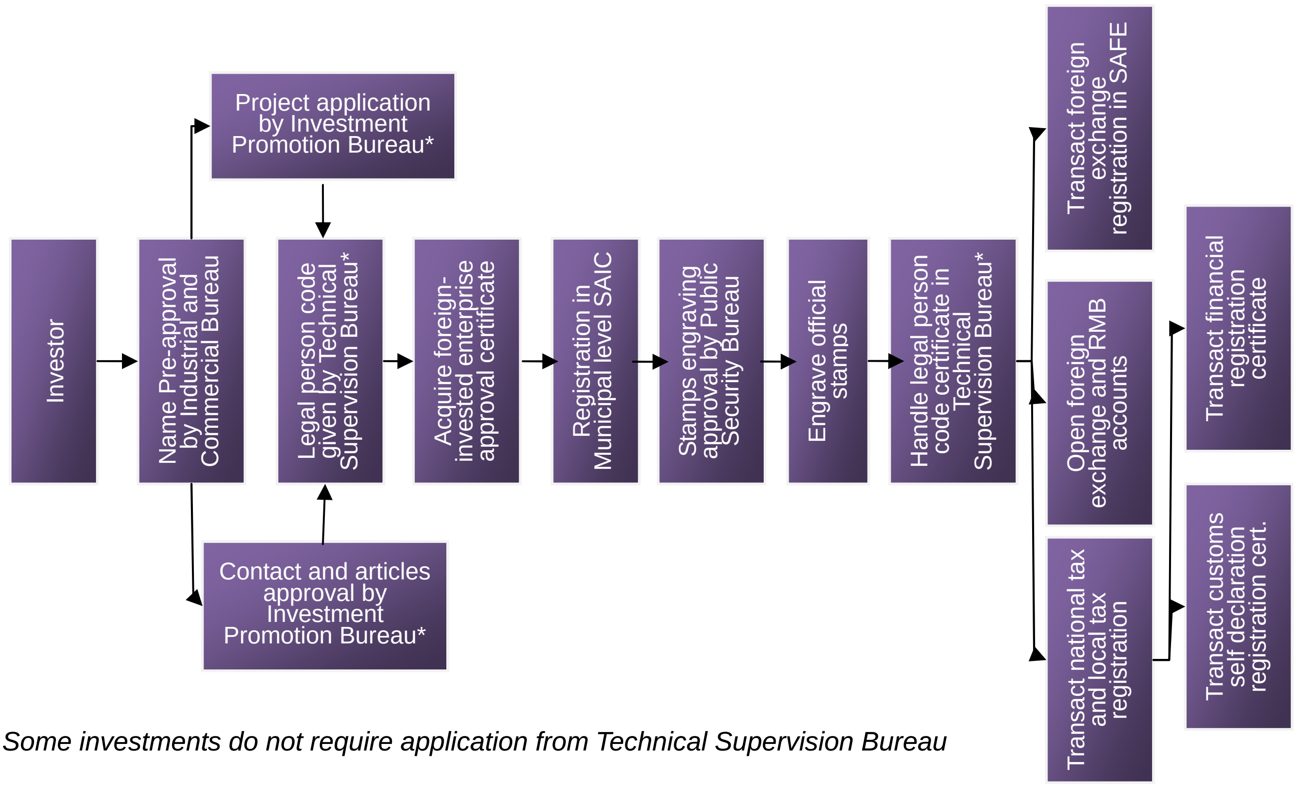
The general withholding tax rate for dividend is 10% for foreign investors without permanent establishment in the PRC. Preferential treaty withholding tax rates of 0% / 5% / 7% / 7.5% / 8% are available to various treaty countries and arrangement jurisdictions for qualified beneficial owners.

WFOE can remit dividends to Foreign Investors from WFOE's designated bank account after obtaining tax clearance



Investment Procedures

A flowchart on examination, approval and registration procedure is as follow:-



** Some investments do not require application from Technical Supervision Bureau*

It generally takes a few months to setup a WFOE. Hong Kong holding companies can choose among 150 authorized lawyers for notarization whilst non-Hong Kong investors are required to get notarization through the PRC Council in their home countries. This offers huge time and cost saving so many investors setup a Hong Kong holding company to avoid such administrative burden. Hong Kong also entered into Closer Economic Partnership Arrangement with the PRC which allows Hong Kong companies to participate in restricted businesses. Hence, many foreign investors set up a Hong Kong company as an immediate holding vehicle. Consequently, Hong Kong companies constitute more than 70% of the shareholder of WFOE.

What You Need to Be Aware Of?

Notwithstanding the New PRC Company Law removed the minimum paid up capital requirement, WFOE still needs to have a certain level of capital investment before the domestic Administration of Industry and Commerce approves the business license. Certain administration procedures have to be completed before the capital can be released. Re-investment of foreign capital is subject to approval. Foreign currency must also be kept in the designated bank accounts permitting the bank to supervise the transactions. Remittance overseas must also be reported on a regular basis. As corporate seals / stamps have equal legal status over signature in the PRC, many foreign investors find it unsecure to maintain the seals in the hands of legal representative. *Boardroom China* would be able to assist our clients to secure the seals to reduce the risk of power abuse by the local management to erode the investments.

From the financial prospective, WFOE is required to allocate a reserve fund of at least 10% of the after-tax profits up to a cumulative amount equal to 50% of its registered capital. Profits may not be distributed until losses from the preceding years have been made up. Sometimes local tax authorities may request taxpayers to pay withholding tax even when the dividends have not been remitted to overseas investors. As such, investors need to have early strategic plans over profit repatriation. *Boardroom China* would be able to assist our clients from daily bookkeeping to business advisory.

Contact Us

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