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Wholly Foreign Owned Enterprise and Representative Office Compared

1. Wholly Foreign Owned Company (WFOE)

(1) Status

WFOE is an independent legal entity registered with only foreign capital in China and under Chinese law. The managing director (if only one director is appointed) or Board of directors and legal representative are appointed by the foreign parent company. The WFOE abides by the Chinese company law and regulations like any other Chinese company.

(2) Legal liability

The WFOE is liable to its assets like a limited liability company in Western legal practice. The capital to be registered is according to the business operation cost. In some cities and for some industries, the minimum registered capital is required.

(3) Commercial Activity

Chinese corporate law restricts companies to their business scope, i.e. the range of business activities it can perform. The business scope of a WFOE is usually restricted to manufacturing or trading or general service activity.

Within its business scope, a WFOE can conduct legal business activities within and outside China, such as purchasing, processing, and reselling commodities. The WFOE can also declare customs, import and export according to its business scope.

Local currency can be exchanged against hard ones provided it is for legal buying activities in respect with the business scope. Profits can be repatriated in foreign currency.

(4) Personnel

Local staff is hired directly under the Chinese labor law. They do not make it difficult to hire and fire people. Trade unions are encouraged but not obligatory. In any case, they have proved to be no hindrance to the management. Foreign employees can be appointed and receive work and residence permits as well as the appropriate visas.

(5) Premises

The WFOE must be located in those premises reserved for commercial activities, i.e., commercial buildings or commercial-cum-residential buildings.

(6) Taxes

WFOE pays income tax and VAT as Chinese companies, income tax is usually 25% of the net profit, VAT is according to its industry.

Tax breaks can be obtained for encouraged industries or export-oriented industries and in some cities. Generally speaking, WFOE is only liable to income tax at a reduced rate at 15%.

In addition, WFOE normally obtain the right to import all of their production equipment free of VAT and customs tax.

Personal income tax of the WFOE must be deducted from the employee's monthly salaries and paid by the employer.

(7) Requirements for Registration

The WFOE must be approved to be registered. This approval will include checking:

(a) The proposed name of the WFOE
(b) The articles of associations of the company and the business scope, they must abide by foreign investment law.
(c) The premises rental contract
(d) The resumes and passports of the board members and their proper appointment by the mother company's legal representatives
(e) The parent company's certificate of incorporation

2. Representative Office (RO)

(1) Status

It is an office of a foreign company in China. As such it is not a Chinese company and no registered capital as well.

(2) Legal Liability

The RO is not a separate legal entity and therefore it does not assume liability on its own. Instead, the foreign parent company assumes the liability of the RO. This liability thus extends to the registered capital and assets of the mother company.

(3) Commercial Activity

(a) As the RO is not a Chinese company it does not enter into business transactions as a Chinese company, but as a foreign company.
(b) Consequently, the RO does not have a capital, it does not buy or sell in its own name.
(c) It has a bank account that is used only to receive money from the mother company and pay for its local expenses.
(d) The RO cannot declare customs, import or export goods, as the mother company does not have such a right in China. It can however receive mail, parcels of samples and send out such samples. It can also import equipment and goods for its own use. (Computer systems, other office equipment's.)
(e) The RO can act as a liaison between its parent company and the parent company's business partners in China. It can conduct purchase or sales negotiations, quote prices or receive quotes from suppliers, effect market research, market and promote its parent company products, hold seminars, take part in exhibitions.

(4) Personnel

(a) As a foreign company office in China, the RO does not fall under the labor law for Chinese companies. As well it is not entitled to enter into own arrangements with local staff as it cannot register for and provide social welfare.
(b) Local staff can be hired with the approval of specialized Chinese human resources companies to which fees must be paid in addition to the staff's salary. These fees provide the necessary and legal social welfare cover to the local staff. The formal labor contract is signed with the Chinese HR company.This agreement may be copied to the HR company or remain strictly between the local staff and the RO.
(c) Foreign representatives approved by the relevant authorities receive a work and residence permit as well as the corresponding work visa. A local staff can be appointed as Chief Representative.

(5) Premises

As a foreign company in China, the RO is restricted to use specifically approved premises for its offices, be they bought or rented. However, a RO could be located in those same buildings as allowed for a WFOE.

(6) Taxes

(a) The RO is liable to pay taxes in China, though it is not a Chinese company. These taxes can be calculated in 2 ways, subject to the approval by the Chinese Government:
- according to a percentage of the profits generated by the RO for the foreign company
- as a percentage of the expenses of the RO.
Tax authorities have no proper way to evaluate profit generated by the RO for the Mother company. As a result, they require at least that tax be no less than the percentage on expenses. This is usually the way foreign company choose to be taxed.
(b) Staff (local and foreign) and liable to pay income tax according to Chinese law. This tax is paid by the employee or the foreign company as per agreement with the staff.

(7) Requirements for Registration

The RO must be approved before it can be established. The approval includes checking of:

(a) The financial situation of the parent company (usually in the form of a bankers' reference letter issued by the banker of the parent company).
(b) Latest audited financial statements must also be supplied (this requirement only applicable to RO in restricted industry).
(c) The personal situation of the appointed Chief Representative, including his resume and passport.
(d) The location of the RO (lease agreement for the office premise must be produced).

3. Representative Office or Wholly Foreign Owned Enterprise

(1) The RO is usually a first step for a presence in China. It is a completely sufficient and suitable structure for any market developing activities.

(2) A WFOE is always recommendable for any production, processing or distribution activity. A WFOE is the solution and preferred choice for foreign investors making a presence in China.

The alternative could be a JV. However, in general a JV partner active in the particular field of activity of the JV brings no real advantages and often additional problems. Foreign investors who intend to establish JV should analyze successful JV on a case-by-case basis and find out the reasons for their success.

If you wish to obtain more information or assistance, please visit the official website of Kaizen CPA Limited at www.kaizencpa.com or contact us through the following and talk to our professionals:
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