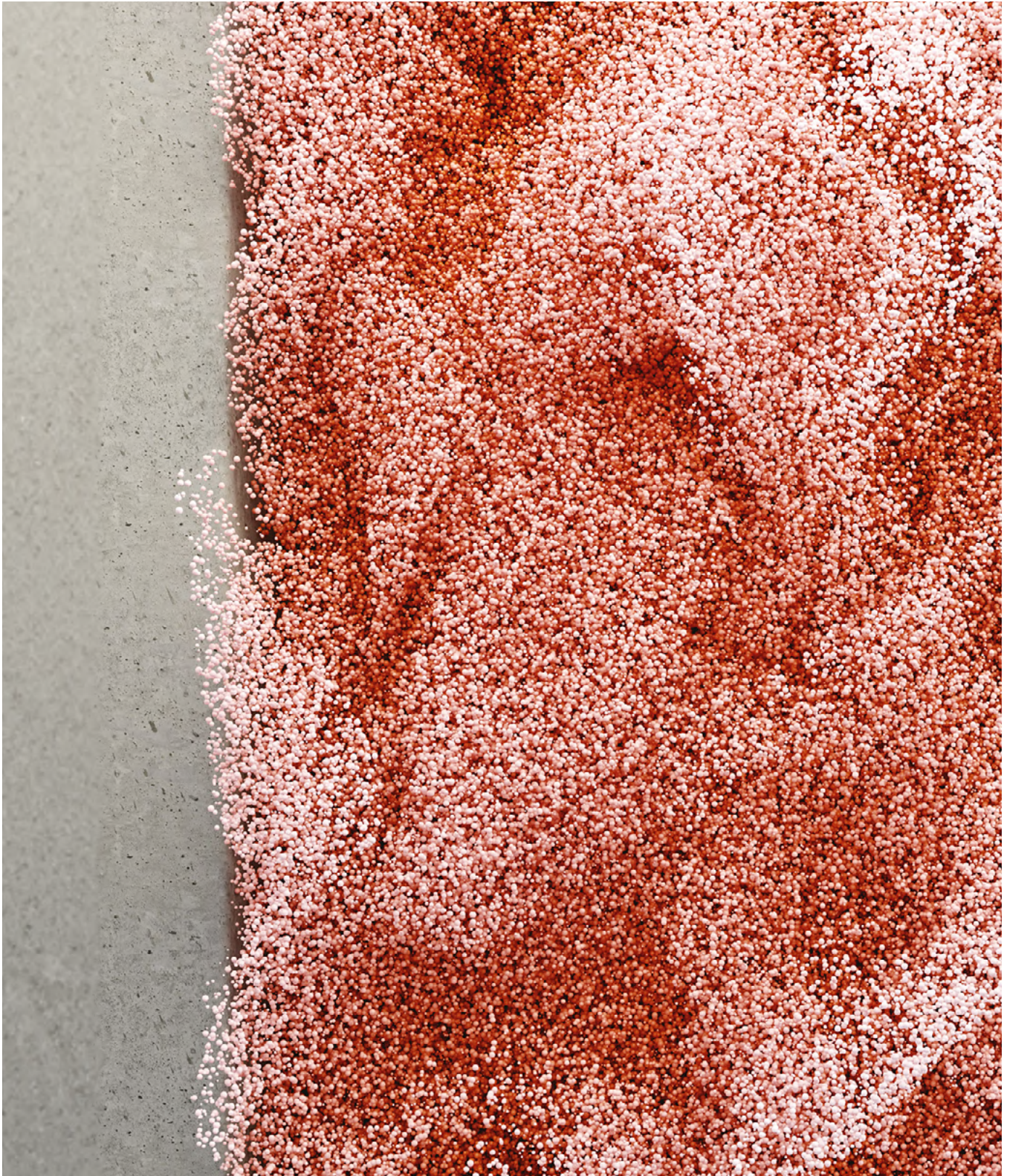


The China Market Entry Handbook

Navigate the **Complexities of
China's Market** with Confidence





Disclaimer:

The content of this publication is for informative purposes only. It is not intended to replace the advice of an accounting, tax, or HR specialist. Individuals and businesses looking to apply the contents of this publication are strongly advised to seek the help of a professional.

FOREWORD



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The global economy has undergone significant shifts after the pandemic, and China has emerged as a key player in the new landscape. With the country's growing domestic demand for foreign products and expertise, there has never been a better time for businesses to establish or expand their presence in the Chinese market. As we enter 2023, China's ongoing economic reforms and new policies have created a more mature and accessible market for foreign companies than ever before. The tax and regulatory environment now aligns more closely with Western and international practices, presenting unique opportunities for growth and collaboration.

However, despite these favorable conditions, foreign invested enterprises in China still face challenges related to tax administration and compliance procedures. Navigating the complexities of Chinese regulations is essential to ensure compliance from the outset, mitigating the risks of non-compliance, and maximizing the efficiency of internal procedures.

Many of the tax and regulatory compliance practices that foreign invested enterprises are encouraged to adopt can be reliably outsourced to a trusted third-party service provider. At Integra Group, we assist foreign investors and multinational enterprises in adopting practices into their business which are designed to mitigate risks and drive efficiency – while ensuring compliance and safeguarding assets in China.

As you embark on your journey of doing business in China, we hope this publication serves as a valuable guide, equipping you with the knowledge and tools necessary to thrive in this dynamic market.

Jessie Lin



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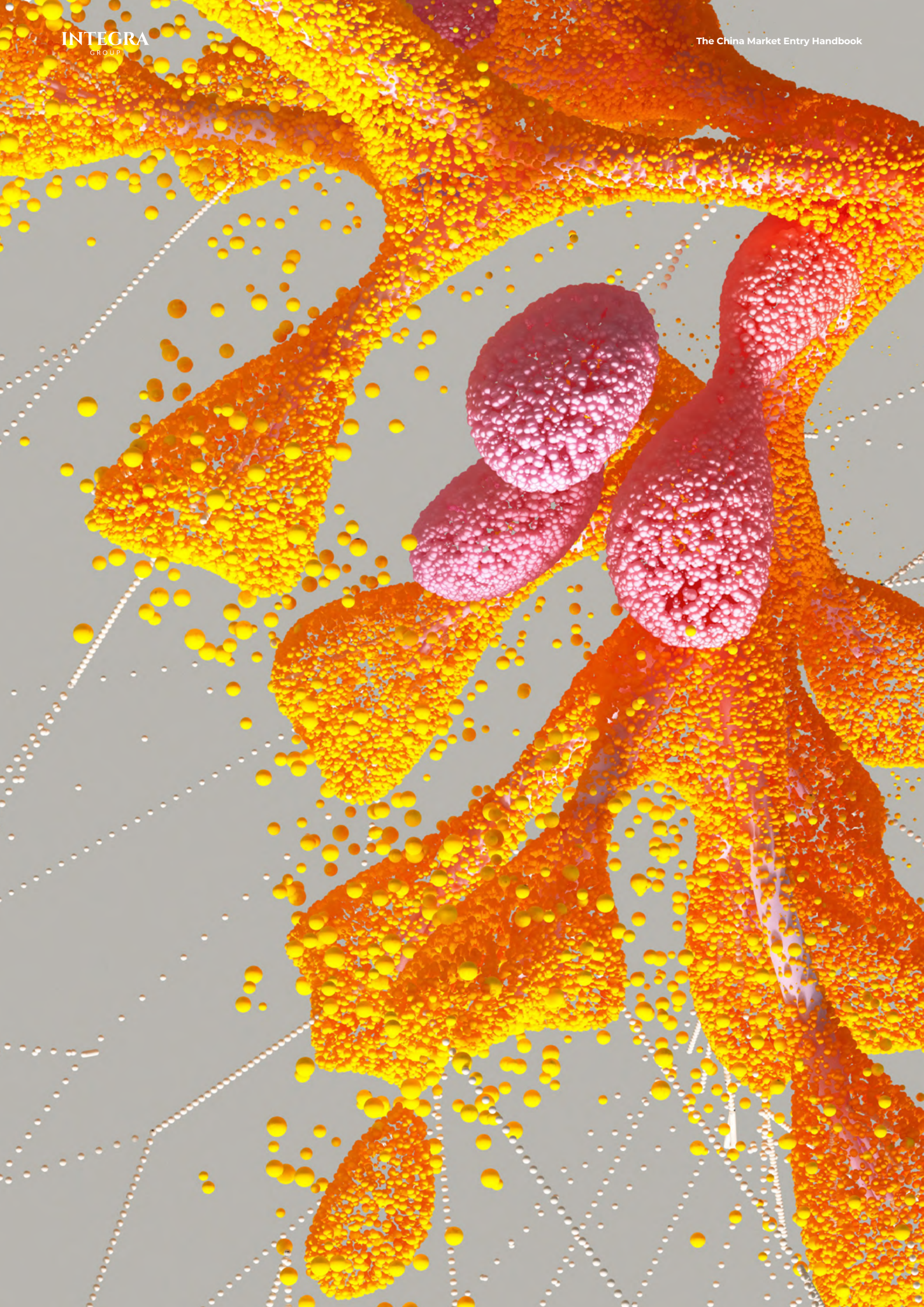
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How to Properly Set Up a Company in China

Registering a Foreign Invested Enterprise (FIE) is the first step in your journey of doing business in China. During the setup process, foreign investors must make some important decisions that will determine their allowed business activity and impact the taxes they pay.

Properly forming an FIE in China requires investors to understand the implications of the decision they make early on. Here you will be presented the key elements of registering an FIE in China and how to decide what is right for you.

Entity Type

Three main types of FIE exist in China, each with their own characteristics and intended purpose.

Wholly Foreign-Owned Enterprise (WFOE) – is the most common legal entity type for foreign investment in China and is suitable for most forms of business ventures. WFOEs can hire local and expatriate employees and engage in commercial business activities in accordance with their business scope.

Joint Ventures (JVs) – are legal entities with shared ownership between two or more parties. Equity Joint Ventures (EJV) share risk and return equal to an investor's share of ownership. Co-operative Joint Ventures (CJV) share risk and reward according to the terms of a contract – allowing for more structural flexibility over an equity joint venture. EJVs can sometimes provide foreign investors access to industries restricted for foreign investment.

Representative Office (RO) – are not considered legal entities in China but instead as an extension of overseas entities. Their intended purpose is to liaise with local parties and coordinate promotional activities in China on behalf of their overseas head offices and therefore cannot engage in commercial businesses in China. They can hire employees using a third-party HR agent and are taxed based on their costs – as opposed to revenue.

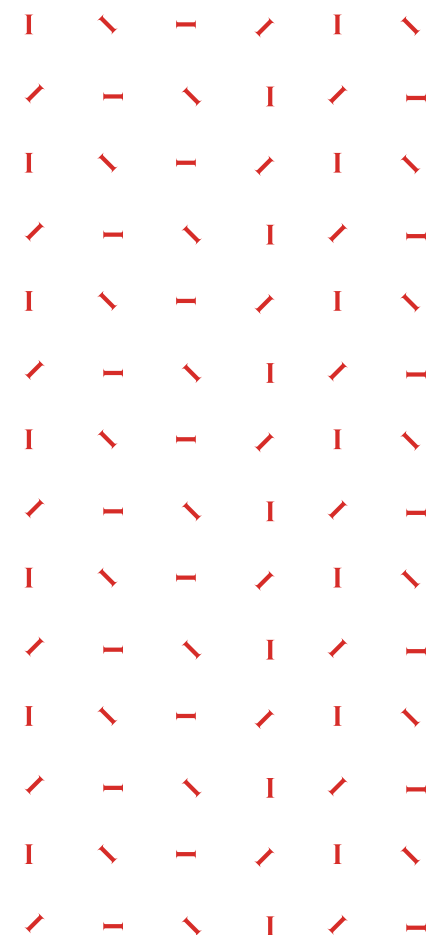
Business Scope

The business scope is defined by the business and submitted for approval by the State Administration for Market Regulation (SAMR). The business scope plays an important role in China as it determines the types of business activity the business can legally engage in and the items for which the business can provide an official VAT invoice (fapiao).

When determining the desired business scope, foreign investors should create an exhaustive list of the products and services that they wish to offer and align their descriptions with the official Industry Classifications.

Business activities in China are classified as either “Prohibited”, “Restricted” or “Encouraged” according to the “FI Encouraged List”, “FI Negative List”, and the “MA Negative List”.

Encouraged industries are often eligible for preferential treatment and tax incentives whereas restricted industries are subject to special conditions such as shareholding limits as well as special approvals by the government. Prohibited industries are entirely off-limits for foreign investment. Industries that do not appear on any of these lists grant equal market access to foreign investment as domestic investment.



FI Encouraged List - Catalogue of Encouraged Industries for Foreign Investment (2022)

FI Negative List - Special Administrative Measures on Access to Foreign Investment (2021)

MA Negative List - The Negative List for Market Access (2022 edition)

Industry Classification - The Industrial Classification for National Economic Activities

Legal Persons

When registering a business in China, there are mandatory legal positions that must be filled and verified through real-name authentication. There are no restrictions - such as nationality - or qualification for who can hold these positions.

Legal Representative – is the most important role in the company as they are the default authorized signatory. Typically, this is the sole investor themselves, or a person designated by the executive director or board of directors of the China company.

Executive Director – is appointed by the shareholder to manage the company. Investors can also appoint a board of directors which must consist of 3 or more persons. For small businesses, the executive director is typically the same person as the legal representative.

Financial Responsible Person – is a mandatory position and cannot be the same person as the Legal Representative or Executive Director. Typically, this is the company's internal finance manager or a third-party financial services provider.

Supervisor – is also a mandatory role and cannot simultaneously hold any other legal roles within the company. The supervisor should be independent of the daily operations of the company. This role is normally fulfilled by the CFO or a legal counsel to the investor company. You can view the supervisor is like an auditor who may examine the books and records of the China company to ensure full compliance of (both external and internal) rules and regulations.

Registered Capital

The amount of registered capital - together with the total investment - is defined on the Articles of Association submitted by the investors during the business license application process. It is the primary source of funding for the company to meet its financial obligations before it is self-sustaining.

For most business types, there are no minimum required capital requirements, unless otherwise specifically set out in laws, regulations, or State Council decisions currently in effect. Investors are not required to inject the full amount of registered capital upon registering the company – nor is the registered capital required to stay in the bank account. It can be spent on capital assets like machinery and equipment or operating expenses like inventory, salaries, rent, etc.

The period for which capital can be injected normally is dictated by the company's articles of association - up to the life span of the company's operating period. Thus, the registered capital can be injected over time in order to meet a business's financial obligations. For SMEs, we recommend as a 'rule of thumb' to estimate 6 months' worth of operating expenses and asset purchases as the declared registered capital.

Foreign Debt Quota – is the difference between total investment and registered capital and is capped by the SAIC. Foreign debt allows investors to provide short-term or long-term funding to the business to help it meet its financial obligations.

Foreign Debt Quota = Total Investment – Registered Capital

| Amount of Total Investment(USD) | % of Minimum Registered capital to Total Investment | Note: |
|---------------------------------|---|--------------------------|
| 3 million or below | 70% | |
| 3 million - 10 million | 50% | Not less than USD \$2.1m |
| 10 million - 30 million | 40% | Not less than USD \$5m |
| 30 million or above | 1/3 | Not less than USD \$12m |

Macro-prudential Method

Additionally, enterprises can choose to apply the Macro-prudential Method for calculating the upper limit of the amount of foreign debt they are permitted to register (Yingfa [2017] No. 9). The Macro-prudential Method may allow the enterprise to register a foreign loan greater than what is permitted under the standard Foreign Debt Quota.

The foreign debt calculated using the Macro-prudential Method must be submitted to the SAFE for approval.

Foreign debt limit = (Assets & Net Assets) x (Financing Leverage Ratio) x (Macroprudential Adjustment Parameters)



Marcia Lin

Manager
Beijing Office

“
Properly establishing a company in China comes down to finding the most effective way to carry out certain business activities from both a tax and operational perspective.”

Other Issues

There are several other issues that investors should be aware of when registering their business.

Company (Chinese) Name – need to contain four elements: the unique business name, industry description, location, and legal form. The industry description, location, and legal form are determined by the nature of the company and cannot be freely decided upon. The unique business name is up to the discretion of investors. It’s important to remember that the business name is printed on official VAT invoices and engraved on the company’s seal, so it’s generally a good idea to choose something which is simple.

Bank Accounts – All businesses in China are required to have at least two bank accounts; the capital account, for depositing the registered capital, and the RMB basic account for day-to-day business operations. Foreign businesses might also require foreign currency accounts which are separate accounts.

Registered Address – In order to complete the company registration process, businesses must have a valid rental contract to which their business is registered. Some districts allow multiple addresses business to a single address, so make sure to check whether the district you wish to register in allows this before deciding to rent shared office space.

Common Mistakes

One of the common mistakes investors make when registering their FIE in China is selecting a business scope that is not suitable for their planned business activities. For some industries, a business scope that is too broad may prevent the FIE from obtaining preferential policies or tax incentives. On the other hand, a scope which is too narrow can prevent the business from issuing VAT invoices for specific product or service categories.

Another common mistake by investors is allocating too little registered capital. FIEs in China may find it difficult to apply for a bank loan as they lack credit history and assets to secure a loan. The registered capital becomes the primary source of funding for the business until it is cash flow positive. Allocating too little registered capital can prevent investors from providing additional funding in the form of capital injection and financing in order to meet their financial obligations.

These issues can be addressed by making changes to the business license, though this takes time and a cumbersome process to complete. Investors are advised to carefully consider the details of their registration application – and seek the help of a professional if needed.

An overview of the PRC Tax System and Administration

As China becomes part of the global economy and domestic demand for foreign products and expertise continues to grow, more and more businesses are deciding to establish a presence in China. In order to achieve an overall greater return on investment and minimize risks, investors need to fully understand the People's Republic of China (PRC) tax system and the associated costs before making a final investment decision.

Below we provide an overview of the PRC tax system and administration to provide investors background information on the associated tax costs of doing business in China. We also discuss some of the business activities which do not involve direct investment within China and the applicable taxes triggered by these types of activities.

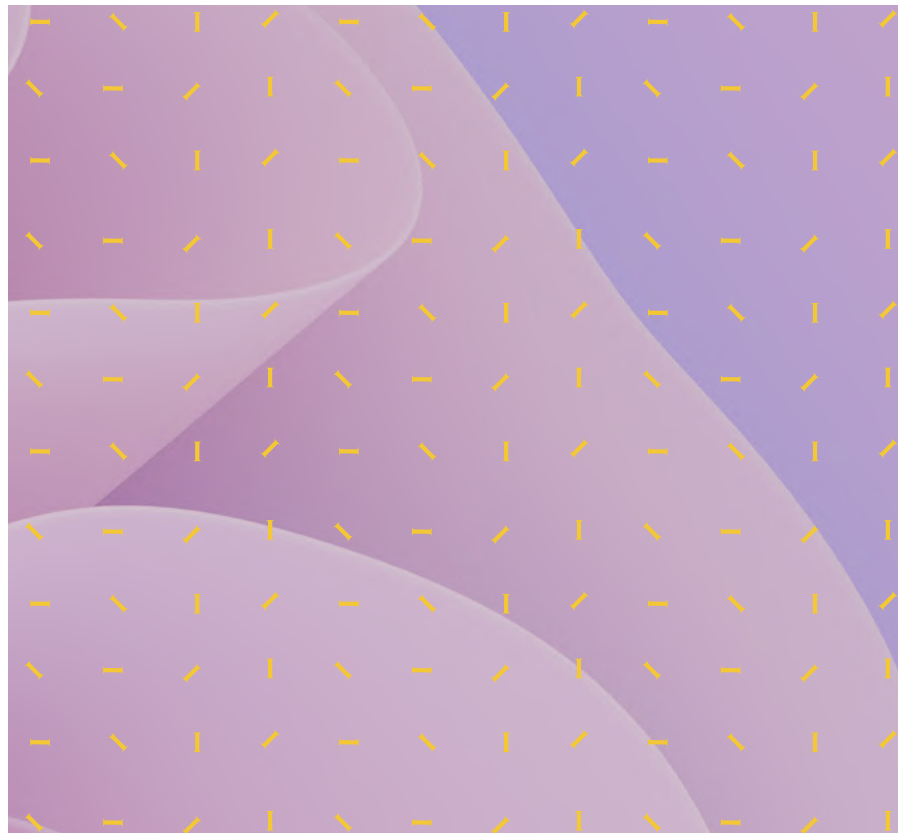
The information provided does not cover taxes levied in Hong Kong and Macau which are special administrative regions of the PRC. Hong Kong and Macau retain their own tax systems and the taxes applicable in Mainland China do not apply in Hong Kong and Macau.

Tax Categories

The major taxes applicable to foreigners, foreign enterprises (FE), and foreign investment enterprises (FIE) doing business in China are as follows:

Value-added tax (VAT) - The sales or importation of goods, provision of services, sales of intangible assets or real estate, are subject to VAT. VAT rates depend on the business scope; sale of goods (13%), special sectors (9% - 10%), and services (6%). Businesses can also register as a small-scale VAT taxpayer and apply a flat VAT rate (3%) levied on total revenue but prohibit the use of input VAT deductions.

Customs duty - applies to imported goods and is based on the value of the transaction or specific duty (e.g. RMB 80 per unit or kg). The applicable duty rates depend on the category of goods and the country of origin.



| Categories | Items | |
|---|--|---------|
| Turnover Tax 流转税 | Value-Added Tax (VAT) | 增值税 |
| | Consumption Tax | 消费税 |
| | Custom Duty | 关税 |
| Income Tax 所得税 | Corporate Income Tax (CIT) | 企业所得税 |
| | Individual Income Tax (IIT) | 个人所得税 |
| Resources, Property, Action Tax 资源、财产、行为税 | Resources Tax | 资源税 |
| | Urban and Rural Land Use Tax | 城镇土地使用权 |
| | Real estate Tax | 房产税 |
| | Vehicle and Vessel Use Tax | 车船使用税 |
| | Urban Maintenance and Construction Tax | 城市维护建设税 |
| | Land Appreciation Tax | 土地增值税 |
| | Vehicle Purchase Tax | 车辆购置税 |
| | Stamp Tax | 印花税 |
| | Deed Tax | 契税 |

Consumption tax - is levied on manufacturers and importers of specific consumer goods such as alcohol, tobacco, cosmetics, jewelry, fireworks, gasoline, automobiles, luxury watch, etc. The tax liability is computed based on the sales amount and/or the sales volume depending on the goods concerned. Consumption tax is imposed in addition to applicable Customs duty and VAT.

Corporate Income Tax (CIT) – is levied on the net profit of the company. Generally; The CIT rate is 25%. The qualified new/high tech enterprises are able to apply for a reduced CIT rate of 15%. For “Micro and Small-sized Enterprises” (MSE), CIT rates range from 5%-25% depending on the total revenue and profits.

Tax Residency

All businesses and individuals, inside and outside of China, are classified either as PRC tax residents or non-PRC tax residents.

PRC Tax Resident Enterprise (TRE) refers to an enterprise established according to the Chinese law or an enterprise established according to foreign laws but with its effective management located in China.

TREs - are taxed on all sources of income - including income derived from overseas. The TREs will be allowed to deduct the tax paid overseas within limit from its tax liability in China provided that a Double Taxation

| Items | | Tax rate |
|-----------------------------|----------------------------|----------|
| Value-Added Tax (VAT) | General VAT Taxpayer | 6% - 13% |
| | Small Scale VAT Taxpayer | 3% |
| Corporate Income Tax (CIT) | Normal Company | 25% |
| | Small and micro enterprise | 5% - 10% |
| Individual Income Tax (IIT) | Comprehensive Income | 3% - 45% |
| | Income from Operations | 5% - 35% |
| | Other Incomes | 20% |

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Individual Income Tax (IIT) – China uses a progressive IIT rates ranging from 3% - 45% for individuals' comprehensive income, 5% - 35% for individual's income from operations (e.g. income derived by private industrial and commercial activity; sole proprietorship; etc.), and a fixed rate of 20% for other incomes (e.g. interest, dividend, incidental income, etc.). For comprehensive income, such as wages and salaries, China's IIT law provides a standard annual deduction of RMB 60,000 and additional itemized deductions available to all individuals.

Other taxes: Resource tax, real estate tax, stamp tax, deed tax, urban construction and maintenance tax, educational surcharge, etc. – are a series of taxes or surcharges levied on specific types of transactions and business activities.

Avoidance Agreement (DTAA) is in place. All registered legal entities in China are automatically classified as TREs. Overseas businesses without a registered legal entity in China can still be classified as TREs if they are determined to have effective management in China.

Non-TREs – are taxed only on China-sourced income. Overseas entities are generally considered to be non-TREs. Representative Offices (ROs) in China are also considered to be non-TREs as they are treated as an extension of overseas entities, and only perform liaison & promotional activities in China for their overseas head offices.



Withholding Taxes for non-TREs

Withholding taxes (WHT) are levied on payments made to overseas entities (non-TREs) and must be withheld by the Chinese entity before remittance can be made.

Passive income derived by Non-TREs – including dividend, royalty, rental, capital gain, and interest are subject to withholding taxes of VAT (6 - 13% per category) and CIT (20%, reduced to 10% under current provisions). Under a tax treaty, the WHT rates can be lower or even exempted depending on the destination country.

If the passive income is derived by a foreign individual of non-PRC Tax Resident, it's subject to withholding taxes of IIT (20%) instead.

A "Tax Completion Certificate" is provided for deducting tax paid in China from the tax liability in the overseas home countries according to the tax treaties.

Double Tax Relief

Double tax relief is granted through Double Taxation Avoidance Agreements (DTAA) signed between China and other countries and provide relief from the double taxation of income, assets, or financial transactions. They allow for tax credits to be claimed in China up to the amount paid in tax to a foreign country within the same tax category – and vice versa. DTAAs effectively reduce the taxes withheld from income or other financial transactions between the two countries.

As of January 31, 2023, China has DTAA's in place with 112 jurisdictions. It's important to consider the implications of a DTA before deciding on a final investment structure for your new company.

Tax Filing Requirements

| | Tax Filing Period | Due Days |
|-----------------------------|---|--|
| Value-Added Tax (VAT) | Monthly (General VAT Taxpayer) | before 15th of the following month |
| | Quarterly (Small Scale VAT Taxpayer) | before 15th from the end of each quarter |
| Corporate Income Tax (CIT) | Quarterly | before 15th from the end of each quarter |
| | Annual Return | before 31st May of the following year |
| Individual Income Tax (IIT) | Monthly | before 15th of the following month |
| | Annual Return - Comprehensive Income | 01st March - 30 June of the following year |
| | Annual Return - Income from operations | before 31st March of the following year |
| | Annual Return - Oversea sourced income for PRC Tax Resident | 01st March - 30 June of the following year |
| Custom Duty | On a transaction-by transaction basis | |

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Businesses in China all have to meet monthly, quarterly, and annual statutory filing requirements. Reporting and tax declaration are mostly done online, through an online tax portal for the local municipality to which your business pays taxes to.

VAT – Value added tax is filed and collected monthly for general VAT taxpayers and quarterly for small-scale VAT taxpayers – due before the 15th day of the following month or following the end of the quarter. Special circumstances may require VAT to be paid upon issuing the tax invoice (fapiao).

CIT – Corporate Income Tax is filed and collected quarterly for all businesses – due before the 15th day following the end of the quarter. An annual CIT reconciliation return is filed once per year, due before the 31st of May of the following year. Businesses should pay the tax shortage or claim back any overpaid taxes during their annual return. Any tax losses may be carried forward for a period of up to five years, subsequent to the year of the loss.

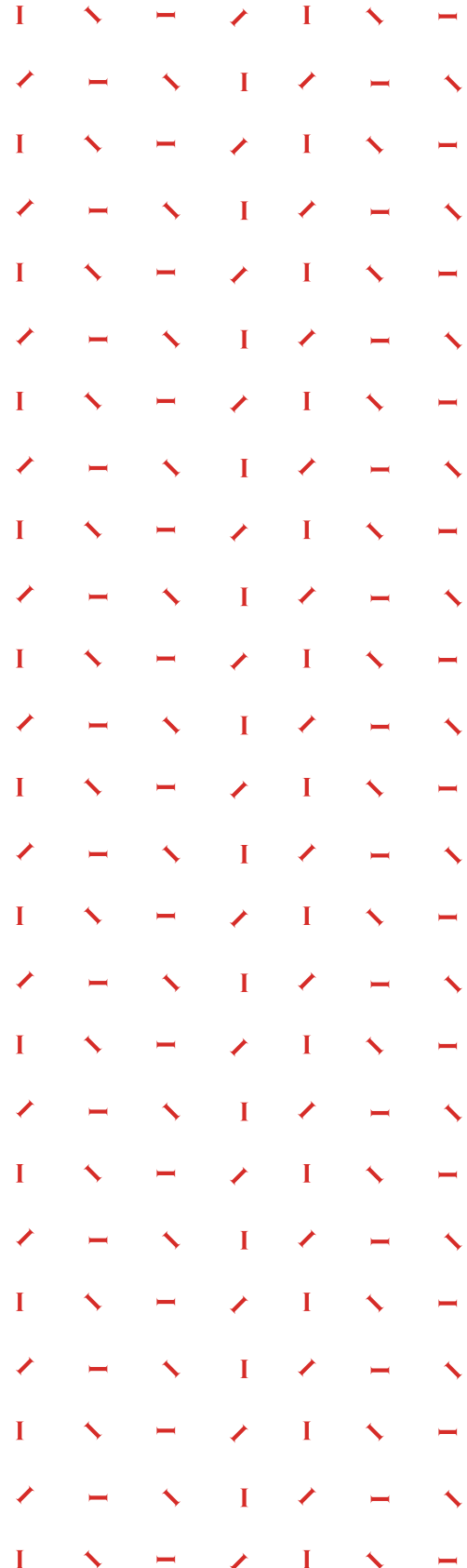
IIT – all individuals are required to file and pay individual income taxes before the 15th day of the following month, either withheld by the withholding agents (e.g. the employers) or through self-declaration by the taxpayers. Individual PRC Tax residents who meet specific criteria must also file an annual tax reconciliation return between 01st March and 30th June of the following year for their comprehensive income.

Preferential Tax Treatments

China employs a “predominantly industry-oriented, limited geography-based” tax incentive policy, aiming at directing investments into those industry sectors, projects, or regions that are encouraged and supported by the state.

Industry-oriented: agriculture, forestry, animal husbandry, and fishery projects; Specified basic infrastructure projects; Environment protection, energy conservative projects; qualified new/high tech enterprises, etc.

The tax incentive policies mainly include tax reduction and exemption, reduced tax rates, and additional tax deductions.



Pierre Wong

Managing Director
Shanghai Office



Investors need to fully understand the China tax system and the associated costs before making a final investment decision



Accounting & Tax Compliance in China

China has over the last two decades progressed to a market-driven system and developed its accounting and bookkeeping procedures more in-line with international standards. However, certain accounting and bookkeeping practices will still present new challenges and considerations for companies setting up in China.

Official VAT invoices (fapiao)

The official VAT invoice system – known locally as fapiaos – is a VAT anti-counterfeit measure developed and implemented by the Chinese tax authorities. Upon issuance, VAT fapiaos will record and share relevant sales data with the tax authorities including sales amount, tax amount, customer name, customer tax registration number, and the type and quantity of goods or service in question.

Two types of official VAT invoices exist. General VAT fapiaos can be used for qualified expense deductions for CIT purposes but cannot offset Input VAT on purchases against output VAT on sales. Special VAT fapiaos, on the other hand, allow for qualified expense deductions for CIT purposes as well as the input VAT amount to be deducted from the output VAT payable. As such, only a net VAT is collected by the tax authorities rather than the full gross amount.

A company is given a limited number of special VAT invoices they can issue within a given period and must request more if needed. Special VAT fapiaos must also include additional information such as customers bank account number, bank name, phone number, and registered address.

The tax authorities closely monitor the issuance of special VAT fapiao as this represents the main source of tax revenues for the government. With the implementation of the new Golden Tax System, the tax authorities are able to keep track of the upper and lower streams of the transaction to ensure VATs are properly calculated and paid to the relevant tax authorities on time. This makes tax evasion and the issuance of a “fake” fapiao virtually impossible to carry out.

Filing Requirements

The fiscal year for enterprises in China runs from January 1st to December 31st. Depending on the nature of the business activities, tax reports must be filed either monthly, quarterly, or by transaction.

The chart on the right summarizes the tax filing requirement for enterprises in China based on their tax registration status:

| China Filing Requirements | | |
|---------------------------|---|---|
| | Small-Scale VAT Taxpayer | General VAT Taxpayer |
| VAT Filing | <ul style="list-style-type: none"> Quarterly filing | <ul style="list-style-type: none"> Monthly filing; Transactional filing |
| CIT Filing | <ul style="list-style-type: none"> Quarterly filing; Annual CIT reconciliation filing | <ul style="list-style-type: none"> Quarterly filing; Annual CIT reconciliation filing |
| Annual Audit | <ul style="list-style-type: none"> Not mandatory for compliance purposes | <ul style="list-style-type: none"> Not mandatory for compliance purposes |
| Joint-Inspection | Required for compliance purposes | Required for compliance purposes |

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Annual CIT return filing

In China, it's common that accounting standards differ slightly from tax laws, often resulting in a difference in the CIT tax payable and the total profits of the companies as shown in the accounting records. The State Administration of Taxation (SAT) requires that all China resident enterprises submit an annual CIT return together with a reconciliation sheet before May 31st following the end of the fiscal year to ensure all tax liabilities have been met according to PRC tax law. Companies must either pay a tax shortage or claim a tax refund during this process.

Companies that meet specific conditions may also be required to submit a tax audit report prepared by a Certified Tax Agent in China for compliance purposes. The conditions vary between local jurisdictions and generally required if the company has incurred substantial tax losses year to date, applying for tax refunds or revenues have met certain thresholds.

Moreover, FIE's that frequently engage in related party transactions and intercompany agreements are also required to file an Annual Related-Party Transaction Report and Transfer Pricing Documentation to assess the impact of the transactions in question on the company's taxable income.

Annual Joint Inspection

FIEs in China are required to undergo an annual joint inspection by the MOFCOM, MOF, SAT, AQSIQ, NBS, and SAFE to serve the information collection requirements of each government department. In a joint announcement by the MOFCOM, Administration of Market Supervision, and SAFE [2019] No. 72 on January 3rd, 2020, the annual AIC filing and the joint inspection will be combined in a single report filed through the National Enterprise Credit Information Publicity System starting with the 2019 fiscal year.

FIE's are required to submit the financial reports for the prior year and additional registration information, including;

- Information regarding the company registration status;
- Information regarding investments in establishing companies or equity purchases;
- Information regarding the paid-in capital in the case the company is a limited liability company or a company limited by shares;
- Information regarding change in equity or transfer of equity of company limited by shares;
- Information regarding the number of employees, total assets, total liabilities, total owners' equity, total revenue, gross profit, net profit, total tax payable, and other financial information.

The Annual Joint Inspection report must be submitted online through the National Enterprise Credit Information Publicity System before June 30th of the following year.

Annual Statutory Audit Report

Currently, an annual statutory audit report is not a mandatory requirement for all companies to meet regulatory compliances. However, if requested by relevant government authorities, the company must provide an audit report signed by a Certified Public Accountant in China. The following are several common scenarios that require the company to produce an annual audit report:

- The company records substantial tax losses cumulatively which jeopardize the continuity of the enterprise;
- The company intends to distribute after-tax earnings to shareholders in the form of dividends;
- Shareholders or trustees mandate an annual audit for internal monitoring purposes;
- The Company is looking for financing in which the lending party requires the latest audit financial report.

An annual statutory audit report in China includes an audit of the balance sheet, income statement, and cash flow statement. Auditors will express an opinion on whether the relevant financial statements fairly state the company's financial position at year-end, operating performance, and its cash flow according to the China Accounting Standards (CAS).

China Accounting Standards

Accounting and bookkeeping practices in China are governed by the China Accounting Standards (CAS) – also known as the Generally Accepted Accounting Principles in China (PRC GAAP). The CAS framework consists of two standards:

Accounting Standards for Business Enterprises (ASBE); and
Accounting Standards for Small Business Enterprises (ASSBE).

Most Foreign Invested Enterprises use ASBE when preparing their annual financial reports – which are structured similarly to IFRS and US GAAP. The ASSBE uses the ASBE as a reference and is intended to make it easier for small businesses to follow accounting standards and tax laws. The tax calculation methods in the ASSBE are designed to be closer to tax laws, thus simplifying the process of making year-end adjustments.

The IFRS recognizes that the ASBE “substantially converge” with IFRS and in a roadmap published by the Ministry of Finance, Chinese authorities declared the ASBEs will be revised and improved in accordance with the revision and improvement of IFRS.

The chart below highlights some important discrepancies between CAS and IFRS.

| CAS vs. IFRS | |
|--|--|
| China Accounting Standards | International Financial Reporting Standards |
| Valuation of fixed assets can only be done using the historic-cost method. | vs. Valuation of fixed assets can be done using either the historical cost method or by revaluation of assets. |
| An impairment of loss on an asset must not be reversed | vs. An impairment of loss on an asset (except goodwill) may be reversed |
| Fiscal years starts from January 1st | vs. The start of the fiscal year can be decided on by the company, but must last 12 consecutive months. |
| Accounts are classified by function | vs. Accounts are classified by nature |

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There are several other minor discrepancies between CAS and IFRS in addition to those mentioned above. Both CAS and IFRS provide more detailed rules on some practices that are common in their relevant jurisdiction and only affect specific financial activities.



Converting CAS Compliant Financial Reports

The issue of different accounting and financial reporting standards is most apparent when financial statements are provided to overseas companies. Group reporting is not possible without first converting the CAS compliant financial reports to the reporting standard of a specific jurisdiction.

The information on the Chinese financial reports must be converted to fit the reporting standards of the target jurisdiction, through a process called "mapping". Accountants must first map the accounts on the financial reports to that of the target accounting standard. This is typically a one-time procedure.

Accountants also need to pay special attention to the differences in the accounting standards used in China and the standards of the target jurisdiction and identify any financial activities that may be affected. For most companies, this is a manual process. Large companies can develop specialized software to carry out this function in real-time based on their requirements.

Enterprises in China are encouraged to seek an accounting and tax professional for meeting their accounting and tax compliance requirements. If you have any concerns about the compliance status of your business or would simply like to improve on your compliance procedures, contact Integra Group for advice based on your individual circumstances.

Anny Wu

Senior Manager, Accounting & Compliance
Shanghai office



Accounting compliance is not just about meeting government requirements, it's also about providing business owners the clarity and confidence in financial reports to assist them in making important decisions.



Hiring Employees, Contractors, and Freelancers in China

High on the list of priorities for companies doing business in China is hiring employees to help grow their business. With the growing availability of local talent in China and the many benefits they bring to the company, foreign invested enterprises in China often put emphasis on building up their local teams.

Notably, relevant labor laws and their implementation is inclined to protect the employee in China. Thus, its equally important to implement HR management practices that ensure compliance and manage risk as it is to develop management practices that attract top talents.

Laws and regulations governing the hiring of employees in China are mainly as follows:

- Labor Law of the PRC (中华人民共和国劳动法), issued 1994 and most recently revised in 2018;
- Labor Contract Law of the PRC (中华人民共和国劳动合同法), issued in 2008 and most recently revised in 2012.
- Social Insurance Law of the People's Republic of China (中华人民共和国社会保险法), passed in 2010 and most recently revised in 2018.

It should be noted, additional laws, such as the Implementation of Labor Law of the PRC, exist to supplements laws governing HR practices in China and provide necessary clarification on their intended interpretation.

Labor Contracts

Labor Contract Law of the PRC is predicated upon Chinese and Expatriate employee's right to know which days and hours they are expected to work. A standard labor contract should thus include the following:

- Location at which work should be carried out,
- Days on which the employee is expected to work; and,
- The number of hours to work each day.

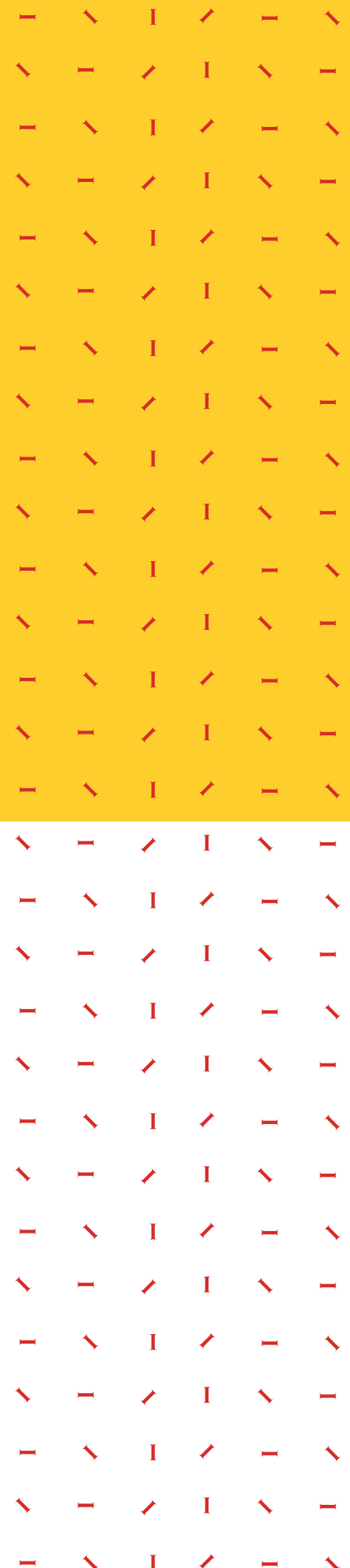
Furthermore, Labor Law of the PRC mandates the standard number of working hours, rest days and holidays. Employers should note the following laws:

- The standard workday should last up to 8 hours.
- Any work performed after 8 hours within a single day are considered overtime and shall be paid at 150% of the employees' hourly rate;
- The maximum amount of overtime

- performed per day is 3 hours;
- The maximum amount of overtime performed per month is 36 hours;
- Overtime hours performed on rest days should be paid at 200% of the employee's hourly rate; and
- Overtime hours performed on statutory holidays should be paid at 300% of the employee's hourly rate.

The State Council of the People's Republic of China will announce - generally in September - the statutory holiday schedule for the following year.

Under Article 39 of the Labor Law of the PRC, enterprises who are unable to implement the provisions of the standard working hour system are, with the approval of the local labor bureau, allowed to implement other working hour systems. These are known as the Comprehensive Working Hours System and the Flexible Working Hours System.



Comprehensive Working Hours System

The Comprehensive Working Hour System refers to the comprehensive calculation of working hours based on the cycle of weeks, months, quarters, years, or other predetermined amount of time, but the average working hours and the average weekly working hours shall be the same as the standard working hours.

Under a Comprehensive Working Hour System, employers and employees can set the number of working hours worked per cycle according to PRC Labor Law before statutory overtime payments are invoked. Note, when overtime payments are invoked, the standard rates according to PRC Labor Law is applied.

Enterprises in China can implement a Comprehensive Working Hour System for the following types of employees:

- Employees in transportation, railway, post and telecommunications, water transportation, aviation, fishery and other industries who need to work continuously due to the special nature of their work;
- Employees in industries restricted by seasons and natural conditions, such as geology and resource exploration, construction, salt production, sugar production, and tourism; and
- Other employees who are suitable for the implementation of the comprehensive working hours system.

A Comprehensive Working Hour System must be approved by the local Labor Bureau before they can be utilized and may need to be renewed annually.

Flexible Working Hours System

The Flexible Working Hours System refers to that employees can choose the specific work schedule flexibly and autonomously on the premise of completing the prescribed work tasks or fixed working hours, instead of the unified fixed commuting time system. Under this Flexible Working Hours System, if the employee worked on the weekend for the tasks, overtime pay can be avoided.

Enterprises in China can implement a Flexible Working Hour System for the following types of employees:

- Senior management personnel, field personnel, sales personnel, on-duty personnel and other employees who cannot be measured by standard working hours system due to the special nature of their work;
- Long-distance transportation personnel, taxi drivers, loading and unloading personnel of railways, ports, warehouses, and employees who need mobile operations due to the special nature of their work; and
- Other personnel suitable for a Flexible Working Hours System to due to production characteristics, special needs of work, or scope of duties.

A Flexible Working Hours System must be approved by the local labor bureau before they can be utilized and may need to be renewed annually.

Probation period

According to Article 19 of Labor Contract Law of the PRC, the probation period terms of a labor contract are limited as follows:

- If the fixed term of the labor contract is more than 3 months but less than 1 years, the probation period shall not exceed 1 month;
- If the fixed term of the labor contract is more than 1 year but less than 3 years, the probation period shall not exceed 2 months;
- If the fixed term of the labor contract is more than 3 years or is a non-fixed-term labor contacts, the probation period shall not exceed 6 months.
- During the probation period, the employer shall not terminate the labor contract unless the employee falls under the following circumstances:
 - The employee is found not to meet the conditions for employment during the probationary period or the employee satisfied the criteria for immediate termination outlined in Article 39 of the Labor Law of the PRC;
 - The employee cannot perform his duties due to illness or injury, or,

determined to be unqualified after training or adjusting the job.

- Employers may not stipulate a probation period for fixed-term labor contracts with a term of less than 3 months and Task-based labor contacts.

Confidentiality obligations and non-competition clauses

Article 23 of the Labor Contract Law of the PRC stipulates that an employer and the employee may agree in the labor contract on confidentiality obligations and non-competition clauses to protect the employer's business secrets and confidential matters related to intellectual property rights.

For employees who are obligated to keep confidential information, the employer may agree with the employee to provide the employee a monthly payment within the non-competition period.

According to the Shanghai Higher People's Court of Labor Judicial Interpretation, if the labor contract provides a non-competition clause but did not provide details on the compensation amount to the employee, the employee can claim non-competition compensation through negotiation with the employer during the non-competition period. If an agreement through negotiation fails, the non-competition payment to the employee typically falls between 20-50% of the worker's previous normal wages for a period of no more than 2 years. If the employee violates the agreement, they shall pay the employer damages in accordance with the agreement.

The persons subject to restrictions on confidentiality and non-competition shall be limited to:

- Senior management;
- Senior technical personnel; and
- Other personnel with confidentiality obligations to the employer.

The confidentiality obligations and non-competition period shall not exceed two years.

Employment Handbook

According to Article 50 of Labor Contract Law, the company shall establish labor rules and regulations in accordance with the law. But it is not always suitable for all rules and regulations to be included in the labor contract in which case many companies will utilize the Employment Handbook.

An employment handbook can provide a detailed overview of company-specific policies, procedures, guidelines, and benefits while also providing legal protection. In the event of a labor dispute such as the company having been accused of wrongful employment termination, harassment, and discrimination claims, courts will rely heavily on the contents of both the labor contract and employee handbook in determining the outcomes of the dispute. A clear and well-thought-out employee handbook offers a critical layer of protection against employee lawsuits or claims.

Payroll Requirements

Article 50 of Labor Law of the PRC stipulates that wages shall be paid monthly to the workers themselves in the form of currency. In practice, this has been interpreted as wages shall be paid no less than once per month.

Regardless of the duration of the payroll cycle, the company must perform the individual income tax calculation and filing on a monthly basis using the employee's gross monthly salary. Employers are required to act as withholding agents for their employee for the purpose of individual income tax.

In the event of a public holidays or rest day, salary payment shall not be delayed and shall be paid in advance.

Hiring freelancers and Contractors

As opposed to hiring full-time employees, the agreement between a company and a contractor or freelancer is not governed by Labor Law of the PRC. This means the company is not bound by the requirements of the Labor Law of the PRC, such as paying social insurance, paying severance, and providing other benefits such as paid leave and sick leave.

Instead, the company is permitted to define the terms of the service agreement signed between the Company and the Contractor subject to Contract Law section of the Civil Code.

Classification of a Contractor or Freelancer

Freelancer and Contractor are terms used interchangeably with one another to define the working relationship between the company and the individual. The company is considered to have hired a contractor or freelancer if the company pays the individual in exchange for services and is not deemed to constitute an employee and employer relationship.

Company should be careful that their relationship with a contractor does not trigger an employee-employer relationship, thus fundamentally changing the nature of the engagement.

According to the Labor Law of the PRC, an employee-employer relationship is triggered when:

- The company pays the individual a set salary and/or provides insurance or other social benefits;
- The contractor is required to follow the company's guidelines and their work is under the control of the company; or
- The contractor is performing an essential function of the company's core business operations.

Furthermore, if the company has worked with an independent contractor for 10 consecutive years or more or has signed two consecutive fixed-term contracts with the independent contractor, the company is required to sign a non-fixed term labor contract with the individual.

Standard contract terms for hiring Contractors or Freelancers

The terms of the contract between a Contractor and the company are subject to the mutual agreement of both parties. In order to avoid misclassification of the contractor as an employee and to clearly define the working relationship, it is important to define the following standard contract terms:

- The detailed scope of work;
- Details of expected tasks for the project to be considered complete;
- The project's start and end date;
- The amount, delivery method, and payment structure of compensation;
- Rights to any intellectual property (IP) created during the engagement if applicable;
- Liability for outcomes and resources used in relation to the scope of work;
- Non-disclosure statements (NDAs) or non-compete clauses if applicable; and
- Clause for termination of the contract for each party.

Employer of Record in China

An Employer of Record (EOR) is a third-party organization that serves as the legal employer for the employees of a foreign company operating in China. By partnering with an EOR, companies can hire local or foreign staff without the need to register a local company or subsidiary. The EOR manages administrative and legal aspects of employment, such as labor contracts, payroll, employee benefits, visa sponsorship, and compliance with local labor laws and regulations.

In China, the Employer of Record service is also known as staff outsourcing. By leveraging EOR services in China, foreign companies can enjoy several advantages:

Simplified market entry

EOR service providers enable companies to start operations in China without the time-consuming and costly process of establishing a local subsidiary. Foreign companies can also use the provider's capacity to rapidly recruit and onboard employees, enabling them to adjust their workforce size according to market demands.

Compliance assurance

Doing business in China presents a unique set of challenges and risks for foreign companies. EOR possesses extensive knowledge of Chinese labor laws and regulations, ensuring that businesses remain compliant and avoid potential hazards or legal complications.

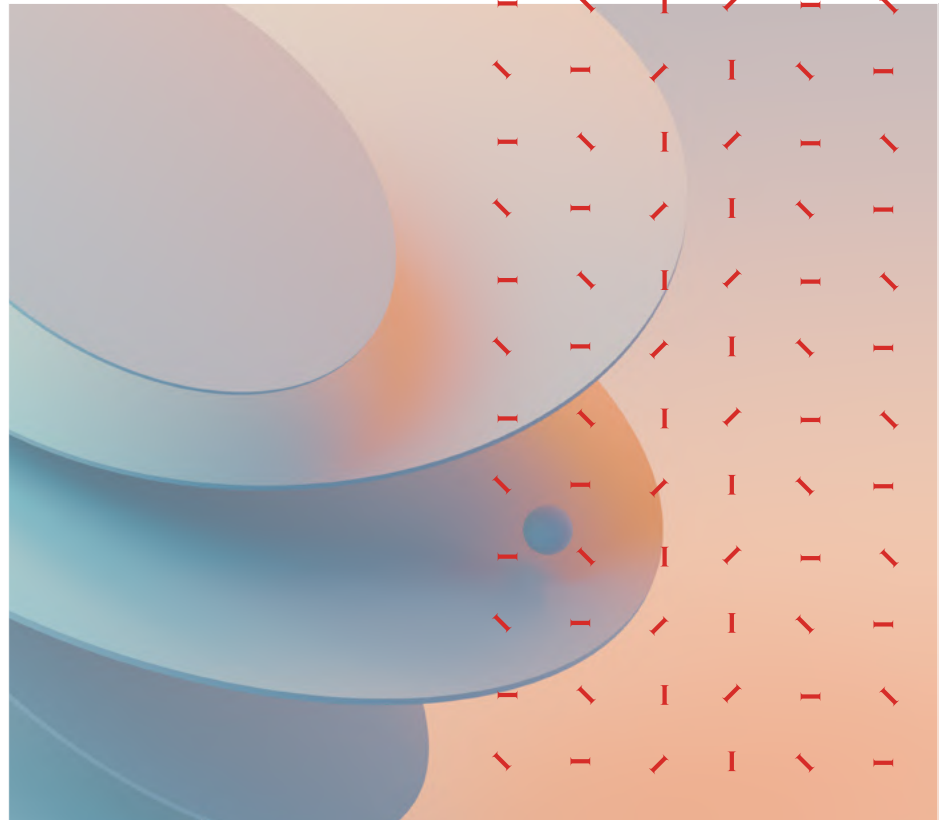
EOR can provide guidance on best practices for protecting intellectual property in China, helping foreign companies safeguard their assets and protect their reputation.

Cost and Operational efficiency

EOR will serve as the employee's nominal employer, handling all the administrative and legal aspects of employment, allowing foreign businesses to concentrate on their daily business activities. This approach also leads to substantial cost savings, as foreign businesses are not required to invest in infrastructure, legal services, human resources, or other overhead expenses.

Enhanced global mobility

EOR can sponsor work visas for foreign employees, making it easier for businesses to hire and relocate talents in China.



Cost of hiring Employees in China

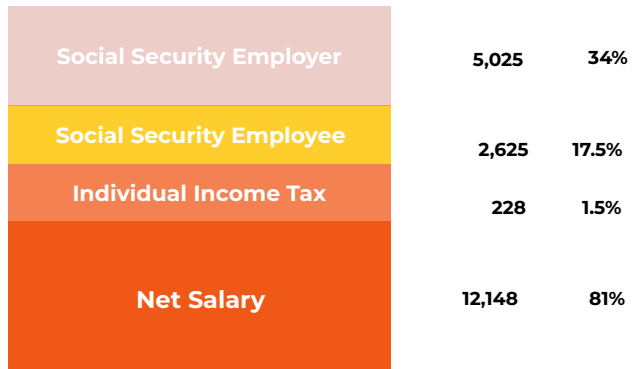
China has the largest labor market in the world and has long been a strategic location for many manufacturers and labor-intensive industries to set up operations. However, as the Chinese economy continues to grow and wages rise, so does the cost of hiring in China.

The cost of hiring in China consists primarily of mandatory expenses such as employee's gross salary and social security contributions. It is also common practice in China to provide other incentives and bonuses to employees based on performance or other criteria – though this is entirely up to the discretion of employers.

When considering the total cost of employment in China, employers should first determine the gross salary using fair compensation for similar work in the designated city. Factoring in the various additional costs borne by the employer – such as mandatory social security benefits – and other voluntary benefits, employers can then begin to see the total cost of hiring employees in China.

Example:

| | | |
|---------------------------------|---------------|-------------|
| Monthly employment cost: | 20,025 | 134% |
| Gross salary: | 15,000 | 100% |



Note: The above example is based on 2022 social security rates for Beijing and utilized the RMB 5,000 monthly standard deduction and additional RMB 3,000 itemized deductions.

Compensation and Benefits (C&B)

C&B is typically divided into three parts: wages and salary, incentives and bonuses, and mandatory social security contributions.

- **Wages & Salaries** are generally paid monthly and vary from 12-13 months. A 13th-month pay scheme is common practice – but not mandatory - in China, with the 13th month's pay issued during the Chinese Spring Festival. Overtime pay according to PRC labor law is calculated as 150% of normal wages when performed on weekdays, 200% when performed on rest days (i.e. weekends), and 300% performed in public holidays.
- **Incentives and Bonuses** - are generally tied to individual performance and/or team/company overall performance. They can be paid monthly, quarterly, or annually and

are normally not guaranteed. Examples include individual performance, team performance, profit sharing (payouts based on organizational profitability), comprehensive performance (awards based on the performance of the company, team, and individuals), sales bonuses, sales commissions, and special recognition awards.

- **Social securities** – refers to the 5 social insurances and 1 housing provident fund. Social security contributions are mandatory for both employers and employees and comprise a significant portion of the total employment costs. Generally, the employer portion ranges between 35-40 percent of the employee's monthly gross salary up to a fixed limit.

Normally the contributions are based on the employee's average monthly gross salary of the previous year and are limited to Maximum Base and Minimum Base. The Maximum and Minimum bases are typically 300% and 40% of the local average gross wages of the previous years. However, they differ between cities and are announced by the local government annually.

| China Social Security Contributions | | |
|-------------------------------------|------------------|------------------|
| Category | Employer Portion | Employee Portion |
| Pension Insurance | 13 - 16% | 8% |
| Medical Insurance | 5% - 12% | Around 2% |
| Unemployment Insurance | 0.5% - 1% | 0.2% - 0.5% |
| Work Injury Insurance | 0.1% - 2% | - |
| Maternity Insurance | 0.5% - 1% | - |
| Housing Provident Fund | 5% - 12% | 5% - 12% |

Note: Contributions (including minimum base and cap base) and percentages vary between local jurisdictions and are updated each year for each individual jurisdiction.

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Individual Income Tax (IIT)

Individual income for wages and salary in China is taxed based on a progressive tax system with seven tax brackets ranging from 3%-45%.

| China Individual Income Tax Rate Table | | | | |
|--|----------------|--------|----------|-----------------|
| Level | Taxable Income | | Tax Rate | Quick Deduction |
| | (Monthly) | | | |
| 1 | 0 | 2,999 | 3% | 0 |
| 2 | 3,000 | 11,999 | 10% | 210 |
| 3 | 12,000 | 24,999 | 20% | 1,410 |
| 4 | 25,000 | 34,999 | 25% | 2,660 |
| 5 | 35,000 | 54,999 | 30% | 4,410 |
| 6 | 55,000 | 79,999 | 35% | 7,160 |
| 7 | 80,000 | - | 45% | 15,160 |

| China Individual Income Tax Rate Table | | | | |
|--|----------------|---------|----------|-----------------|
| Level | Taxable Income | | Tax Rate | Quick Deduction |
| | (Annual) | | | |
| 1 | 0 | 35,999 | 3% | 0 |
| 2 | 36,000 | 143,999 | 10% | 2,520 |
| 3 | 144,000 | 299,999 | 20% | 16,920 |
| 4 | 300,000 | 419,999 | 25% | 31,920 |
| 5 | 420,000 | 659,999 | 30% | 52,920 |
| 6 | 660,000 | 959,999 | 35% | 85,920 |
| 7 | 960,000 | - | 45% | 181,920 |

Note: The above Tax Rates are only applicable for Comprehensive Income. Not applicable for other individual income such as interest, dividends, income from lease or transfer of property, incidental income, income from operations etc.

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China tax residents are taxed on their gross wages and salary (including base salary, bonuses, allowance, etc.) minus the employee portion of the social security contributions and allowed itemized deductions. All China tax residents are also allowed an additional RMB 60,000 standard deduction per year.

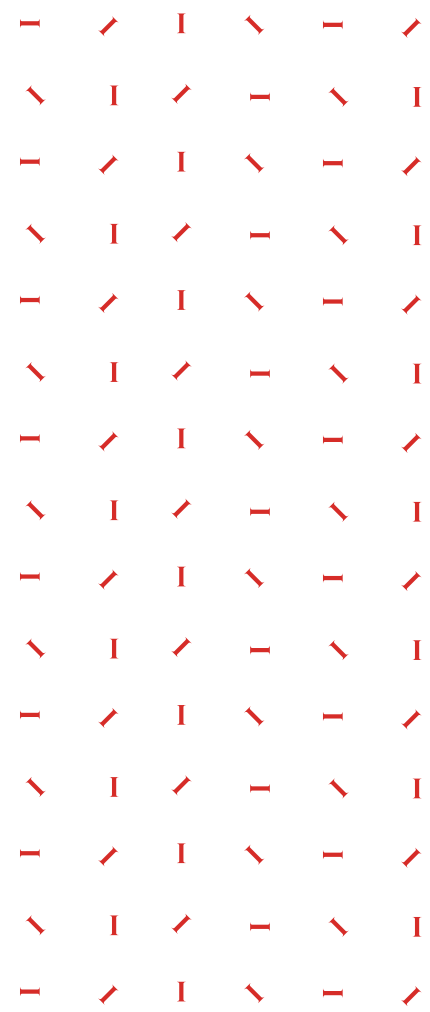
Taxable Income = gross salary – employee social security contribution – standard deduction – additional itemized deductions – other allowable deductions

Expatriate employees currently enjoy more preferential policies when it comes to deductible expenses. Until December 31st, 2021, expatriates can fully deduct certain expenses items from their taxable income – without clearly defined limits. Starting in 2022, expatriates will no longer be able to enjoy the preferential tax treatment but can still utilize the standard itemized deductions available to all China tax residents.

| Itemized Deductions | | | |
|-------------------------------------|------------------------|---|--|
| Preferential policy for expatriates | | Standard itemized deductions | |
| Children's education | No cap* | Children's education | Cap at 1k/month/child |
| Housing rental | No cap* | Housing rental | Cap at 1.5k/1.1k/800/month |
| Meals & laundry | No cap* | Housing mortgage interest | Cap at 1k/month up to 20 years |
| Relocation & travel allowance | No cap* | Expenditures on dependent parents | Cap at 2k/month/family |
| Language training | No cap* | Continuing education expenses | Diploma: Cap at 400/month up to 4 years; Professional Qualifications: 3.6k/one-off |
| Airtickets for home visit | Two round trips/annum* | Baby and child care (below 3 years old) | Cap at 1k/month/child |
| | | Healthcare cost for serious illness | Over RMB 15,000 up to RMB 80,000/annum |

*No-cap deductions must be claimed using authentic fapiao (China official tax invoices) and relevant supporting documents.

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IIT for expatriates

- Expatriates who reside in China for cumulative 183 days or longer within a calendar year are considered PRC tax residents. After 6 consecutive years of PRC Tax Residency status, expatriate's worldwide income will become subject to tax in China.
- The table below shows the tax liability for expatriates in China based on various income sources;

| China IIT: Tax Resident & Non-tax Resident | | | | | | |
|--|---------------|----------------------|---------------|--------------|------------------------|--------------|
| | Stay in China | China sourced income | | | Oversea sourced income | |
| | | | Paid in China | Paid oversea | Paid in China | Paid oversea |
| Tax Resident | >=183 days | >= 6 years | Taxable | Taxable | Taxable | Taxable |
| | | < 6 years | Taxable | Taxable | Taxable | Non-Taxable |
| Non-Tax Resident | <183 days | >= 90 days | Taxable | Taxable | Non-Taxable | Non-Taxable |
| | | < 90 days | Taxable | Non-Taxable | Non-Taxable | Non-Taxable |

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Expatriate in China who wants to avoid subjecting their worldwide income to taxation in China, can reset the 6-year requirements by exiting China for more than 30 days consecutively or 183 days cumulatively in any tax year during a 6-year period. According to regulations issued by the PRC Ministry of Human Resources and Social Security, expatriates must also pay into the mandatory social security funds in China. As of Dec 31st, 2019, China has entered into Bilateral Social Security Exemption Agreements with 10 countries providing exemptions from social security contributions for expatriate employees from these countries. However, enforcement of social security contributions for expatriate employees varies between jurisdictions. In practice, many employers in certain cities choose to not make social security contributions for expatriate employees.

Holiday and Leaves:

Public holidays

Public holidays in China are arranged according to both the Lunar calendar and the Gregorian calendar. The central government will announce, typically in November, the public holiday schedule for the following year. In total, there are 11 fully paid public holidays. In addition, the government will typically provide additional “rest days” following the Chinese Spring Festival and Mid-Autumn festival public holidays to extend the holiday. Employees should work one or two rest days (i.e. Saturday or Sunday) to make up for the additional time off given to them.

| Holidays & Statutory Leave | | |
|----------------------------|-----------------------------|---|
| | Duration | Remarks: |
| Public Holidays | 11 days | Fully paid; Public holiday schedule is announced the year prior |
| Annual Leave | 5 - 15 days | Fully paid; Increases with the duration of employment up to 15 days. |
| Sick Leave | Maximum 3 months to 2 years | Paid 40% - 100% of daily wages depending on staff seniority and city/province. |
| Marriage Leave | 3 - 30 days | Fully paid! Rural cities generally have more marriage leave. |
| Maternity Leave | 98 + Additional days | Pay is covered by the local Social Security Bureau up to certain limits! Additional days varies by city/province. |
| Paternity Leave | 0 - 15 days | Regulations regarding paternity leave vary between local jurisdictions, as does the method of calculating compensation. |

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Annual leave

By law, the minimum fully paid annual leave granted to full-time employees is 5 days following one year of employment and increases with the number years of employment as follows – up to 15 days after cumulative 20 years of employment.

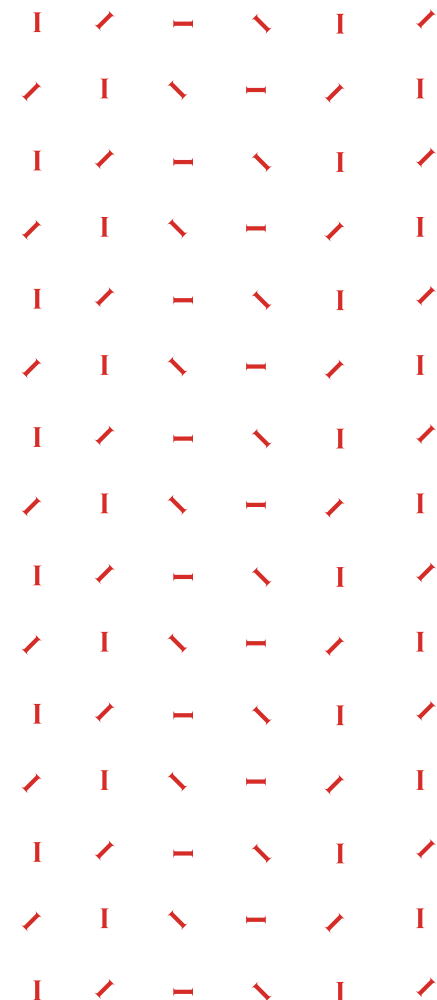
Companies may provide more paid time off as part of their company policy or personal benefits for their employees at their own discretion.

Sick Leave

Employees are granted a fixed number of paid sick days per year depending on the seniority of the employee. The minimum number of paid sick days and pay varies by city/province – generally a percentage of daily wages.

Other Paid Leave

According to China labor law, employees are also entitled to various paid leave such as marriage leave, pre-maternity leave, maternity/paternity leave, funeral leave.



Termination of Employment Contracts

Terminating an employment contract according to China's Labor Laws requires employers to give 30-days prior notice and pay severance to the employee. Severance pay is generally equivalent to one month's salary per year of employment with the company - or half month salary if the employee worked for less than 6 months with the company.

Companies can avoid paying severance if;

- a. Termination of a labor contract is mutually agreed upon; or,
- b. The employee is fired for violation of the labor contract (breach of contract provisions or disciplinary rules) with solid documentation and supporting evidence.

It's important to note that labor disputes in China generally favor the employee. The burden falls on the employer to provide solid documentation and evidence to assert its right to terminate a labor contract and penalty for wrongful termination is generally two times the amount of the original compensation.



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Tax Planning in China: Methods and Preferential Policies

Whether a multinational corporation with operations in various countries or an early-stage business, businesses are naturally concerned about the amount of tax they pay. Businesses aim to achieve greater tax efficiencies and improve cash flow through effective tax planning. However, when operating in overseas markets a key challenge is always navigating the various local tax laws and regulations that apply to the business and its activities.

Tax planning is the means by which businesses regularly assess and strategically manage the tax liability arising from their business activities. Generally, this includes Corporate Income Taxes (CIT), Value-Added-Tax (VAT), and Individual Income Taxes (IIT). As the complexity of a business increases, so does the tax planning considerations. Here we share some of the key tax planning considerations for businesses of all complexities to guide foreign investors in China.

Company Setup Tax Planning

During the company setup, the business owners must make several decisions that affect the future tax payables of the business.

Taxpayer Status

Applying for small-scale VAT taxpayer status allows businesses to apply a flat 3% VAT rate for both products and services – as opposed to the standard 6% (servicing) and 13% (product trading) paid by General VAT Taxpayers. However, small-scale VAT taxpayers are not allowed to offset their VAT payable using input VAT deductions. Instead, they pay a flat 3% VAT on gross sales revenue.

Determining which taxpayer status is more efficient varies case by case depending on several factors including the amount of estimated input expenses, whom your suppliers are, the expected turnover of the company, and more. We suggest working with a professional tax accountant to determine the most efficient taxpayer status based on individual circumstances.

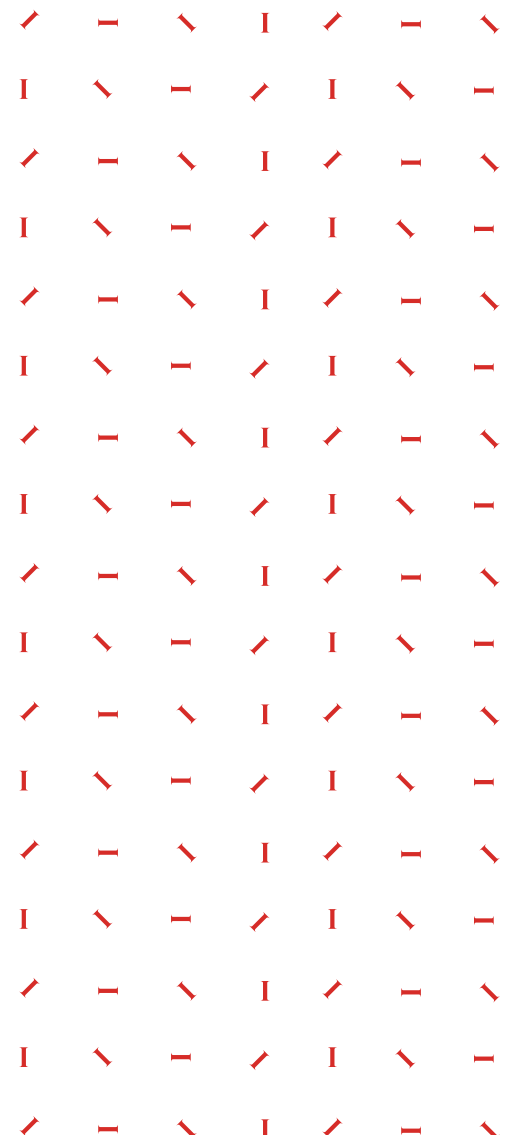
Business Scope

Tax rates vary between products (9% - 13%) and services (6%). Separating products and services allows businesses to apply a lower tax rate for revenue generated through services. Generally, both product and service business scopes can be applied for under a single business license. However, in some cases where it is difficult to separate the service from the product – such as certain hardware and software applications – the company may be required to register two separate companies to effectively apply a lower tax rate.

Additionally, in order to qualify for various preferential policies and incentives, businesses must meet a specified business scope. The business scope cannot be too broad, or it might affect their ability to apply for preferential treatment and incentives.

Preferential policies and incentives

There are various preferential policies and incentives provided in China including – reduced tax rates, special “super deductions”, tax holidays, reduced interest rates,



cash incentives, and other fiscal stimuli. Preferential policies follow the current economic agenda outlined in the various “Encouraged Catalogues” and can change frequently. Generally, they are awarded based on the following factors:

Business activities – such as infrastructure investment, high-new technology enterprises (HNTEs), and other industry sectors which meet the economic and social development needs of each region.

Location – such as Free Trade Zones (FTZ), High-Tech parks, Belt and Road Initiative (BRI) areas, and other areas outlined as “in-need” for investments (Example: China’s Western Regions).

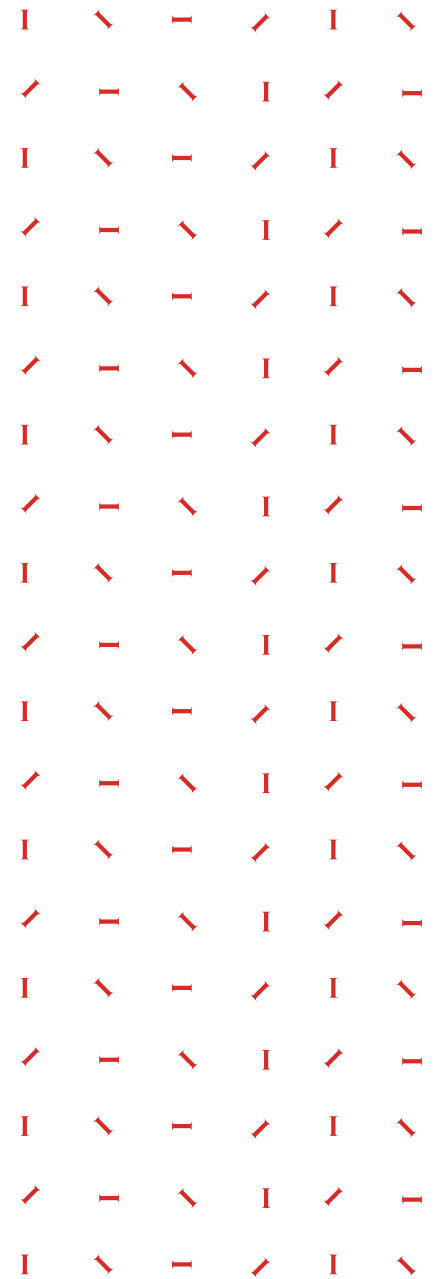
The first stage of applying for preferential tax treatment and incentives requires you to engage with an advisor to determine whether your business meets the qualifications set out by local jurisdictions. In some cases, the criteria are clearly laid out and other times this involves liaising with the relevant regional authorities over the permissible business activities and incentives.

Micro- and Small Sized Enterprises

Micro- and Small Sized Enterprises (MSEs) are defined as “having a relatively small size in personnel and scope of business”. The standard for classification of MSEs is based on the industry, operating income, total assets, and the number of employees belonging to a company. Over 95% of all Chinese businesses classify as MSEs.

Various preferential tax policies are targeted to China MSEs and effectively reducing the tax payable up to prescribed limits, including;

- The first RMB 1 million of taxable income will be taxed at a preferential CIT rate of 20% for 25 percent of their income, with the remaining 75 percent tax-free (effective tax rate 5%).
- Taxable income for the next RMB 1 million to RMB 3 million will be taxed at a preferential CIT rate of 20% for 50 percent of their income, with the remaining 50 percent tax-free (effective tax rate of 10%). In year 2023, there is extra 50% tax exemption (effective tax rate 5%).
- Taxable income above RMB 3 million will be taxed at CIT rate of 25%.
- Small-scale VAT taxpayers with monthly revenue of less than RMB 100k will be exempted from remitting VAT on certain items. If monthly revenue is above RMB100K (monthly filing taxpayer) or quarterly revenue is above RMB 300K (quarterly filing taxpayer), all revenue of small-scale VAT payer will be taxed at VAT rate of 1% in year 2023.



Daily Tax Planning

The transactions a business engages in on a daily business not only have an impact on the cash flow, but also the underlying tax liability of the business. Effectively managing the taxes you pay requires an understanding of how transactions are recorded and their related bookkeeping procedures. Below are some tax planning matters to be considered:

VAT planning

China’s official VAT invoices (fapiaos)

play an important role in the daily tax planning of businesses. Once a fapiao is issued, the resulting VAT payable is due upon the next VAT declaration.

Chinese businesses are required to self-declare and pay VAT monthly or quarterly depending on their taxpayer status. However, special transactions – such as overseas remittances – can sometimes require the business to pre-pay VAT.

Generally, businesses should be mindful when issuing fapiao and carefully monitor each invoice to avoid issuing duplicate fapiao. Good practice is to specify in sales contracts when a fapiao is issued and align those terms with the collection of sales revenues. Businesses should also be mindful of purchase contracts and request fapiaos be issued together with the payments made to those suppliers.

CIT planning

Taxable income is revenue minus qualified expense deductions. Regardless of whether the company made a profit, an unqualified deduction can result in the business paying CIT on some of its expenses.

Expenses entered into the financial records without an accompanied fapiao, or an unqualified fapiao attached are considered to be unqualified expenses. It is important the business maintains up-to-date financial records and implements procedures to ensure supporting fapiao are qualified to protect the integrity of their accounting records.

The deductibility for certain expenses is limited based on the thresholds set by the tax authority. Expenses beyond these limits are required to be “added back” for income calculation purposes and levy applicable CIT rates to said amount. It is important to monitor these tax-deductible thresholds and be mindful of the additional tax payable above these limits.

Benefits of tax planning

Tax planning has many benefits for companies of all sizes ranging from operational cash flow to a lower underlying tax liability. Companies are advised to consider the tax planning methods discussed and adopt policies to monitor their tax payable regularly. A majority of businesses, especially MSEs, can enjoy the benefits of tax planning using these methods.

In addition, the tax planning methods available to companies meet a certain degree of size and complexity go beyond those discussed here. These include businesses with large R&D expenditure, multinational companies with subsidiaries in China and overseas, and companies with a mix of both services and products. Companies that meet these general criteria should spend more time exploring the tax planning options available to them and how they can maximize their benefits.

For more information about tax planning in China and assistance with applying these methods, businesses are advised to speak with a professional tax accountant or advisor.

| Expense Category Limits | | | |
|---|-----------------------------|-----------------|--------------------------|
| Deduction Item | Deduction Base | Deduction Limit | Transferable |
| Employee Benefits | Annual Gross Salary | 14% | Non-transferable |
| Employee Union Fund | Annual Gross Salary | 2% | Non-transferable |
| Employee Educations | Annual Gross Salary | 8% | Transferable |
| Business Hospitality (Entertainment etc) | Deductible Expense Amount | 60% | Non-transferable |
| | Limit: Annual Gross Revenue | 0.5% | Non-transferable |
| Marketing & Advertising | Annual Gross Revenue | 15% | Transferable |
| Marketing & Advertising: Cosmetics, Pharmaceuticals, and Beverage | Annual Gross Revenue | 30% | Transferable |
| Marketing & Advertising: Tobacco | Non- deductible | 0% | Non-transferable |
| Public Welfare Donation | Annual Gross Profit | 15% | Transferable for 3 years |

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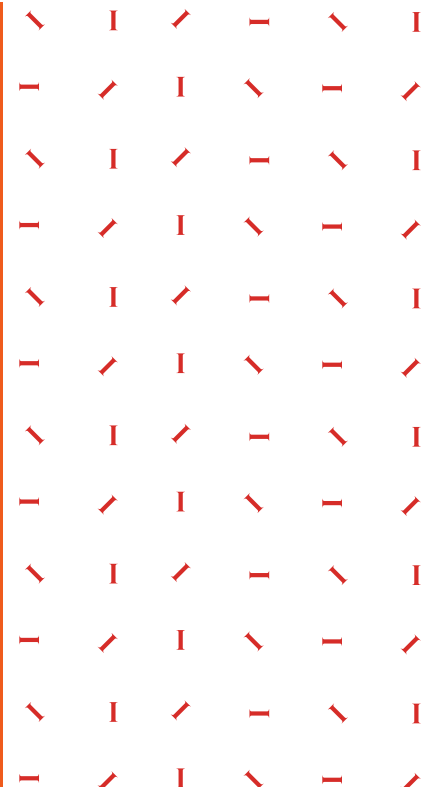


Gigi Yin

Senior Manager
Shanghai Office



Multinational companies engaged in the Chinese market need to consider not only their tax compliance in China, but also their overall tax structure and whether there are any tax efficiencies to be had.



Profit Repatriation Strategies for China

China has long maintained strict foreign exchange controls over funds leaving the country, meaning foreign investors face a series of compliance challenges before they can successfully move funds out of the country.

With the current pace of regulatory changes and with the banks adopting different anti-money laundering procedures, foreign investors in China are naturally concerned about their ability to move funds and most importantly, repatriate profits to their home countries.

Foreign investors in China are advised to use the various methods available to them to best optimize the tax liability resulting from funds leaving the country. In this article, we discuss the four primary ways for foreign-invested enterprises (FIE) to repatriate profits as well as applications of transfer pricing in China.

Profit Repatriations (Dividends)

Dividends to shareholders are the most commonly utilized method for FIEs in China to repatriate profits to foreign entities - despite being a fairly costly method for repatriating profits.

Dividends can only be paid from after-tax earnings following the annual CIT reconciliation - i.e. the annual tax filing - typically in May of the following fiscal year. The relevant tax authorities will confirm the total amount of profits which can be paid as dividend and whether all previous year's losses have been made up.

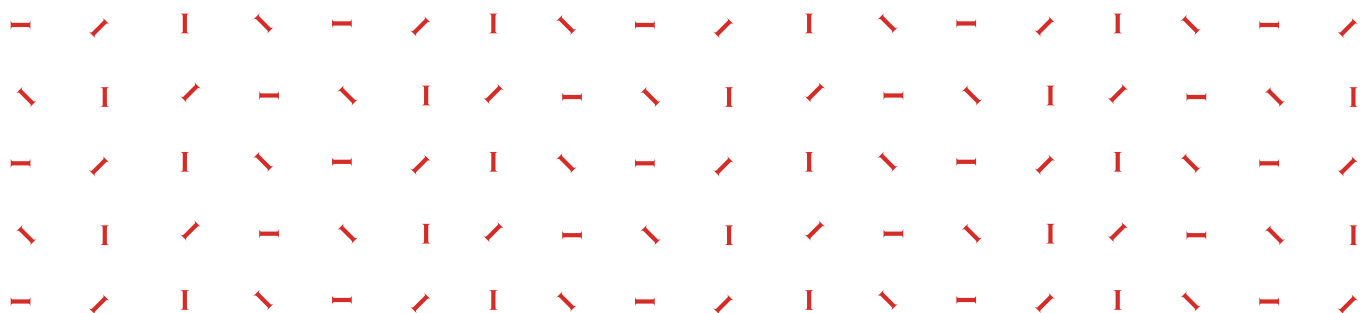
Additionally, FIEs who wish to repatriate profits must place at least 10% of net profits in a reserve account - up to a limit equal to 50% of the registered capital. Reserve funds can further be used to cover future losses, cover

operating expenses, or be reinvested in the business at a later date.

China provides various tax benefits that lower the taxable corporate income - such as those enjoyed by qualified micro, small, and medium-sized enterprises. These effectively increase the amount of retained earnings which can be paid as dividends making it a more efficient means of repatriating profits

| Dividend Payment | | |
|-----------------------------|-------------------------|--------|
| | Calculation | Amount |
| Profit | (a) | 100 |
| Corporate Income Tax | (b) = (a) x 25% | 25 |
| Mandatory Reserve | (c) = (a - b) x 10% | 7.50 |
| Withholding CIT* | (d) = (a - b - c) x 10% | 6.75 |
| Net amount for repatriation | - | 60.75 |

* Withholding CIT paid in China can be deducted from the tax liability overseas under a DTAA.



Service fees

Certain business functions may be carried out at the group company level or by a related party in exchange for a service fee. Some examples include accounting, HR, information technology, marketing, and other supporting functions that can be administered at the group level. For service fees paid to overseas, the China entity must withhold CIT, VAT and other local surtaxes on behalf of the overseas entity. CIT is calculated based on the standard 25% CIT rate and a deemed profit ranging from 15% to 30% for revenue from project operations, design and consulting services, and 30% to 50% for revenue from management services.

The process of engaging in intercompany service agreements has become simpler in recent years. However, given their potential for misuse, tax authorities reserve the right to call into question the validity of intercompany service agreements. It's important that the necessary steps be taken to ensure such agreements are done in compliance with PRC laws and regulations should they be challenged by Chinese authorities.

| Service Agreements | | |
|-----------------------------|--|--------|
| | Calculation | Amount |
| Service Agreements | (a) | 100 |
| VAT | $(b) = (a) / (1+6\%) \times 6\%$ | 5.66 |
| Withholding CIT* | $(b) = (a) / (1 + 6\%) \times 30\%^{**} \times 25\%$ | 7.08 |
| Net amount for repatriation | - | 87.26 |

* Withholding CIT paid in China can be deducted from the tax liability overseas under a DTAA.

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**Based on a deemed profit rate of 30%.

Royalties

Royalties are fees paid to an entity concerning the use of intellectual property such as patents, copyrights, trademarks, or proprietary technologies. When paying royalties to an overseas entity, the China entity is required to withhold CIT, VAT, and local surcharges before payment out of China can be made. Royalty agreements must also be registered with the trademark bureau and detailed royalty agreements provided, including the rationale for calculating royalty fees.

| Royalties | | |
|-----------------------------|--|--------|
| | Calculation | Amount |
| Royalty | (a) | 100 |
| VAT | $(b) = (a) / (1+6\%) \times 6\%$ | 5.66 |
| Withholding CIT* | $(d) = (a) / (1 + 6\%) \times 10\%^{**}$ | 9.43 |
| Net amount for repatriation | - | 84.91 |

* Withholding CIT paid in China can be deducted from the tax liability overseas under a DTAA.

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**Based on a deemed profit rate of 30%.

Foreign Loan Interest Payments

FIEs in China are permitted to register foreign debt - up to the Foreign Debt Quota - on which they can pay interest to the issuer of the loan. FIEs are permitted to pay interest at a rate not exceeding the official interest rate provided by the Bank of China - generally around 4%.

Furthermore, in order to utilize foreign loans, the business must specify a total investment which is greater than the registered capital on their Articles of Incorporation and register the foreign loan with SAFE.

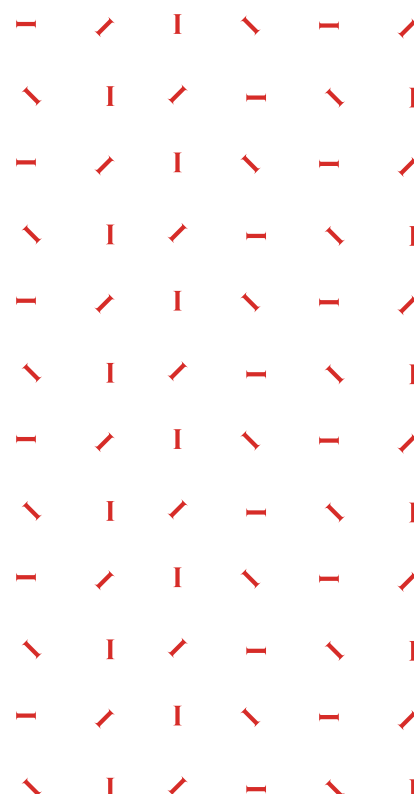
Businesses may decide - within their allowed limits - how much of the total investment they wish to register as a foreign loan. Like with royalties, the China entity is required to withhold CIT, VAT, and local surcharges before payment out of China can be made.

| Foreign Loan Interest Payments | | |
|--------------------------------|--|--------|
| | Calculation | Amount |
| Interest | (a) | 100 |
| VAT | $(b) = (a) / (1+6\%) \times 6\%$ | 6 |
| Withholding CIT* | $(d) = (a) / (1 + 6\%) \times 10\%^{**}$ | 9.43 |
| Net amount for repatriation | - | 84.91 |

* Withholding CIT paid in China can be deducted from the tax liability overseas under a DTAA.

@ Integra Group 2023

**Based on a deemed profit rate of 30%.



Double Taxation Avoidance Agreements

Double Taxation Avoidance Agreements (DTAA) signed between China and other countries provide relief from the double taxation of income, assets, or financial transactions. They allow for tax credits to be claimed overseas up to the amount paid in tax in China – and vice versa.

In some cases, DTAAs effectively reduce the tax withholding rate from income or other financial transactions between China and foreign countries. For example, the DTAA between HK and China effectively reduces the withholding CIT for dividends from 10% to 5% for shareholders with over 25% equity share.

Tax residents of jurisdictions that have a DTAA in place with China may also be granted CIT exceptions and other preferential treatment for intercompany service agreements. However, these are only available on a case-by-case basis and subject to pre-approval of the relevant tax authorities.

When determining a profits repatriation strategy, investors are encouraged to carefully review DTAAs in place – if one exists - between China and the shareholding jurisdiction before making a final investment decision.

How Transfer Pricing works

Transfer Pricing is an accounting practice for establishing the price of goods or services exchanged between two related companies. Transfer pricing is an important concept for multinationals as it allows companies to fairly distribute earnings amongst groups or related parties.

However, due to the potential for misuse or unfair pricing, the tax authorities will often carefully examine both parties involved in such transactions focusing in particular on;

- How each party benefited from the transaction;
- The necessity of services in question;
- The rationale for determining the price – was it done in accordance with the Arm's Length Principle?;
- And in the case of royalties, how much value the company derived from the use of the intangible assets.

Thus, it's important that intercompany transactions are accompanied by detailed supporting evidence and are carried out in compliance with PRC law should they be challenged by the tax authorities.

Additional Considerations

When choosing methods of profit repatriation, one must consider the options available to their unique business situations keeping in mind that the tax authorities in China reserve the right to question the validity of many of the methods discussed. It's also important that the business conducts thorough cashflow forecasts before repatriating profits to avoid needing to further increase its working capital in the future should it need additional funding.



Jessie Lin

Director
Shanghai office



It's not uncommon that a related company provides service or intellectual property in some form without directly invoicing its China subsidiary. Companies should first look at what supporting functions or IP they are receiving and consider whether it can be utilized as a mean of repatriating profits overseas.



ICP Filing and ICP License in China

Understand the ICP in China

ICP stands for Internet Content Provider (ICP). As China maintains strict control over websites, games, apps, and e-commerce within its borders, any “internet content provider” must first register for licenses with the Chinese Ministry of Industry and Information Technology (MIIT) to be able to post information and/or do business online.

The requirement was instated in September 2000 by the Telecommunications Regulations of the People’s Republic of China and Articles 3 and 4 of Administrative Measures on Internet-Based Information Systems:

Article 3. Internet-based information services are divided into services of a commercial nature and services of a non-commercial nature.

Commercial internet-based information services refer to compensatory services which provide information to or create web pages for online users through the Internet.

Non-commercial internet-based information services refer to non-compensatory services which supply, through the Internet, to online users information which is open to and shared by the general public.

Article 4. The State shall implement a license system for internet-based information services of a commercial nature, and implement a filing-for-record system for internet-based information services of a non-commercial nature.

No one shall engage in internet-based information services without having obtained a license or having completed the filing-for-record procedures.

What are the different types of ICP permits?

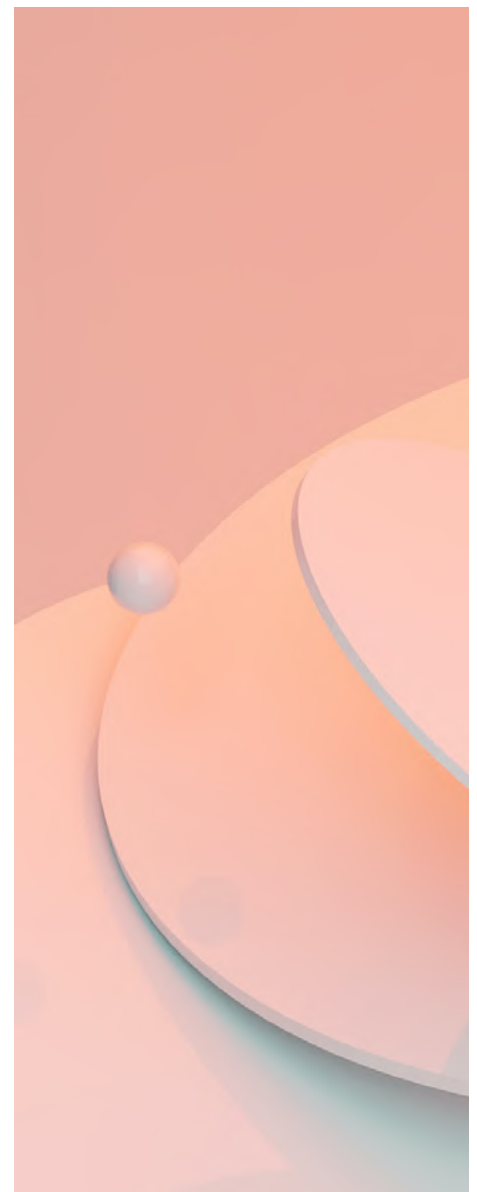
There are two types of ICP permits available in China. Based on your application, game, or platform, your business might need either one or both of them:

- **ICP Filing (ICP 备案)**

The ICP registration, also known as **ICP Beian** or **ICP Recordal**, is a mandatory requirement for hosting a website in China. Enforced by the Chinese Ministry of Industry and Information Technology for non-commercial websites, it is managed at the provincial level for each domain. A distinct ICP Registration is needed for every top-level domain.

For non-commercial sites (sites that are purely informational and not involved in selling goods or services), this is the only ICP required. You cannot generate revenue with an ICP Filing, so if the purpose of your site is to generate revenue, then you will need an ICP License instead. ICP Filing guidelines were established in 2005 in Administrative Measures For the Filing of Not-For-Profit Internet Information Services.

- The numbers follow the format 京 ICP 备 12345678 号 , where the first character indicates the province where the filing was issued. Your ICP Filing will be registered and accessible through an online database. No paper certificate will be issued.



- **ICP License (ICP 许可证)**

An ICP License allows a Chinese company to publish a website, platform, or software in China that generates revenue or provides a platform for others to generate revenue. Its official name is **信息服务业务 (仅限互联网信息服务)**. It is also referred to as an **ICP Zheng**, **ICP Commercial License**, or a **B25 ICP License**, as it is regulated under category B25 in the Value-Added Telecommunication Services (VATS) licensing system.

- An ICP License is issued on a per-company basis. You will still need to submit an ICP Filing for each top-level domain you use.
- These numbers follow the format 京 ICP 证 12345678 号 , where the first character indicates the province where the license was issued.

ICP Licenses are required for:

- o any commercial website (a website that is not purely informational)
- o paid games or games that have in-app payments and/or in-app advertising
- o apps that have in-app payments and/or in-app advertising
- o SaaS platforms
- o app stores or game stores
- o online marketplace for goods, services or information
- o online games
- o live streaming platforms (although an additional, separate license is also required for this as well)
- o community platform services (a platform for question and answer, social sharing or communication)
- o real-time interactive services
(platforms with real-time communication, interactive voice IVR, and video call functions)
- o information protection and processing services (mobile assistants, anti-virus software)
- o shrinking query services (which are not included in browser, with content retrieval in app)
- o information release and express services
(maps, discount networks, libraries, life service and information browsing webpages)

What are the benefits of obtaining ICP permits

- Hosting your website in China ensures quicker loading times and a lower risk of being blocked by the Great Firewall of China.
- You become eligible to use the ".cn" and ".com.cn" domain names, which enhances SEO and boosts credibility.
- Baidu, China's leading search engine, favors websites hosted within the country.
- You gain a considerable edge over competitors hosting their websites outside of China.

Frequently Asked Questions About ICP filing and ICP license

Who is eligible for an ICP Filing?

- Any company registered with a Chinese business license in Mainland China – including joint ventures, Wholly Foreign-Owned Enterprises (WFOE), and 100% domestically-owned companies.

Who can get an ICP License (Commercial)?

- Chinese-owned businesses with a Chinese business license.
- Sino-foreign joint ventures where the proportion of foreign investment does not exceed 50%.

Is it possible for a foreign company to obtain an ICP in China?

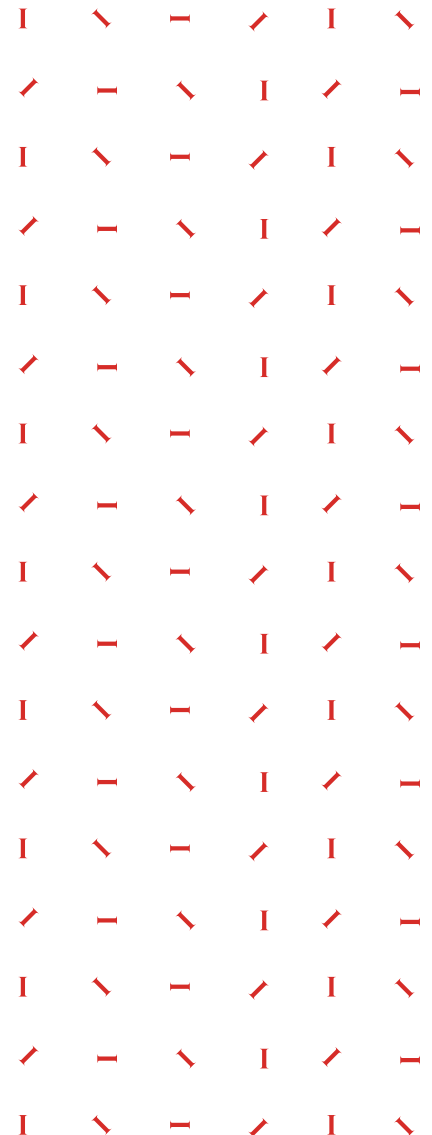
Foreign companies without a Chinese entity are not qualified to obtain an ICP permits. Having a representative office in China is insufficient; you must possess a registered Chinese business license, as mentioned earlier.

What is the process for a foreign company to obtain an ICP permit in order to launch an app or game in China?

Typically, foreign organizations collaborate with Chinese internet companies to launch their platforms, and using the licenses held by the Chinese partner company.

This is where AppInChina can help. We help get you the licenses you need, and you will even be able to avoid some licensing requirements entirely due to our partnership agreement. Our wide range of services and expertise allows you to publish and operate worry-free in China, knowing that you are in full legal compliance with all Chinese laws.

When you sign up for AppInChina's services, you always retain the right to your own content and complete control of your own operations, while at the same time taking advantage of our company status and many years of expertise in the Chinese market. You retain full control and copyright over your app, game or platform through your contract agreement with us.



Rich Bishop
CEO, AppInChina

Abbreviations

CIT – Corporate Income Tax

CJV – Cooperative Joint Venture

DTAA – Double Taxation Avoidance Agreement

EJV – Equity Joint Venture

FE – Foreign Enterprise

FIE – Foreign Invested Enterprise

FTZ - Free-Trade Zone

HNTE – High-New Technology Enterprises

IIT – Individual Income Tax

JV- Joint Venture

MSE – Micro and Small-sized Enterprises

PRC – Peoples Republic of China

RO – Representative Office

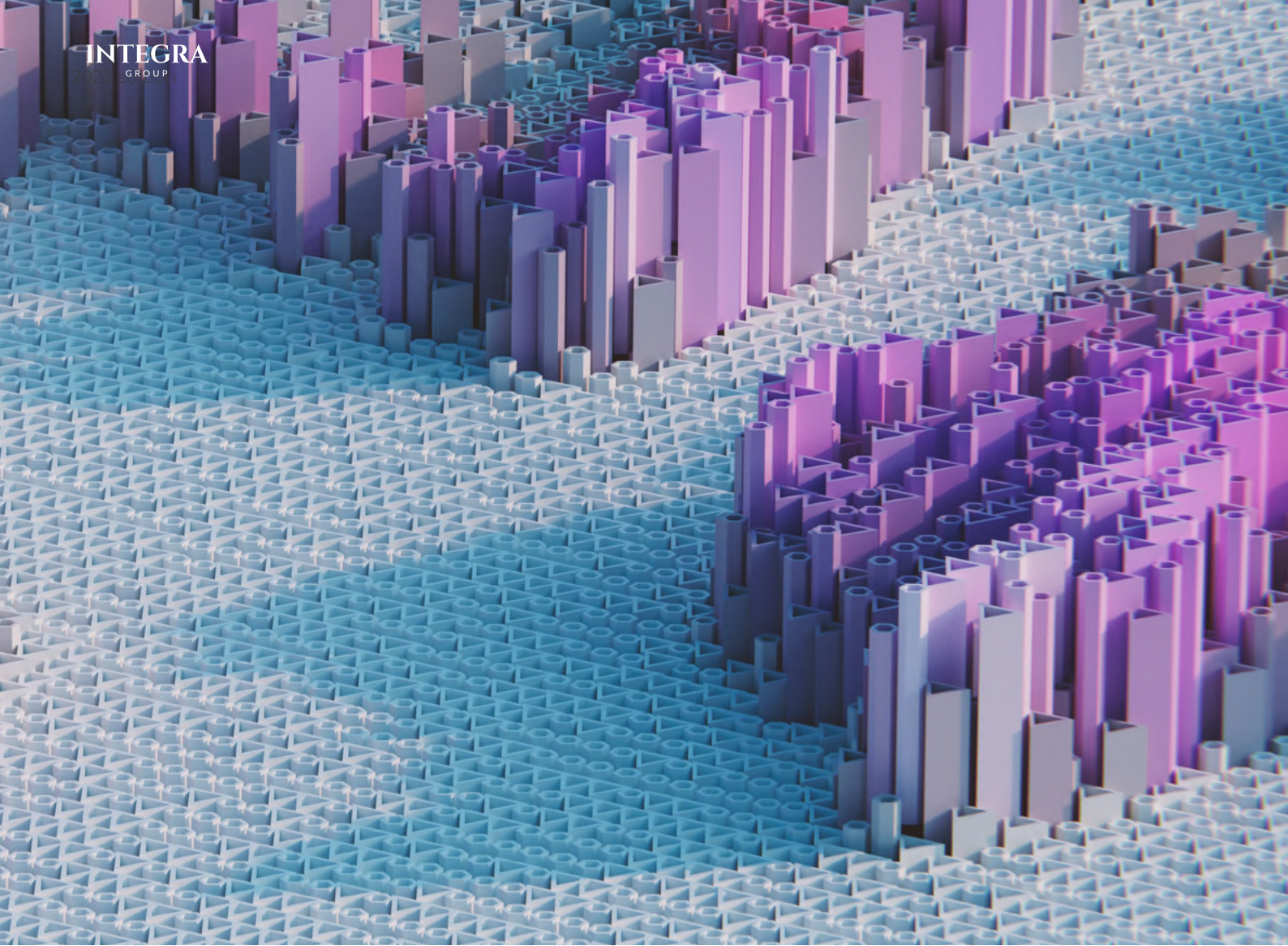
SAIC – State Administration for Industry and Commerce

TRE – Tax Resident Enterprise

VAT – Value Added Tax

WFOE – Wholly Foreign Owned Enterprise

WHT – Withholding Tax



In Conclusion

With Integra Group, you have a team of experts by your side to help you navigate your business as efficiently as possible while providing financial insight to the important business decisions you will face.

We manage and support the accounting, tax, and HR functions with a focus on value and efficiency. Most importantly, we free you up from managing the compliance tasks so that you can spend more time working on your business.

Our Services

Integra Group is a fully licensed Asia-focused accounting, taxation, and business advisory firm – with dedicated offices in Shanghai, Beijing, Singapore, and Taipei. We have helped companies ranging from Fortune 500 companies to small and medium-sized businesses who wish to establish and grow their presence in Asia.



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Get assurance now

If you have any concerns about the compliance status of your business or world simply like to improve on your compliance procedures, contact Integra Group for a free consultation. Speak one-on-one with a compliance expert in China to find what's right for you.



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About Integra Group

Integra Group is an established provider of company incorporation, accounting, tax, HR, and outsourced corporate services in Asia. We help multinational businesses tap into the rapidly expanding Asian markets through our cost effective and reliable corporate services. With our wide range of value-added services and personalized approach, Integra helps businesses unlock new efficiencies and easily navigate the unique regulatory, business, and cultural environment in which they do business.

We have helped companies ranging from Fortune 500 companies to small and medium sized enterprises across a wide range of industries grow their business in Asia. With dedicated offices in Hongkong, Shanghai, Beijing, Taipei, and Singapore, Integra Group is uniquely prepared to help businesses reach their potential in an increasingly global business environment.

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