


Selling in China: Considerations for US companies

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Leading today's discussion

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Today's agenda

- **China as a market**
- **Factors to consider**
- **Possible structures**
- **PRC/US tax & business considerations**
- **Q&A**

China as a market

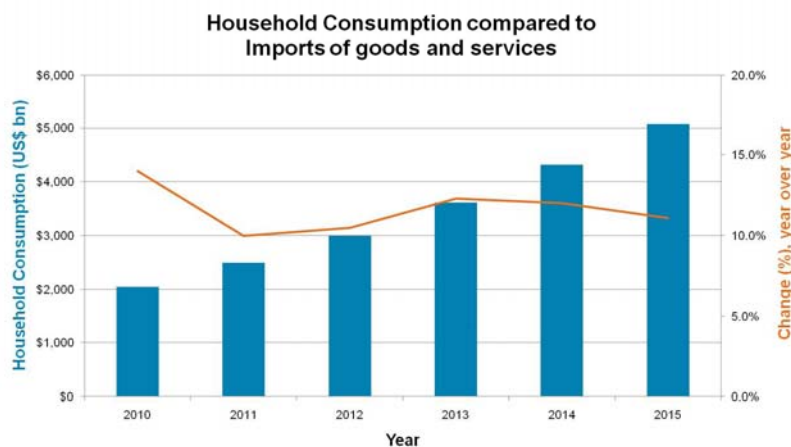
- Growing of Chinese domestic market
- Global factory and supply chain logistics – assembled in China before distribution to the rest of the world
- Complicated business regulations and government control

The Chinese market

	2010	2011	2012	2013	2014	2015
Population (m)	1,312	1,320	1,328	1,335	1,342	1,349
GDP (US\$ bn at market ex rate)	5,878	6,821	8,090	9,569	11,196	12,973
GDP per head (US\$ bn at market ex rate)	4,479	5,166	6,092	7,166	8,341	9,618
GDP (US\$ bn at PPP)	10,241	11,388	12,724	14,162	15,756	17,533
GDP per head (US\$ at PPP)	7,803	8,625	9,582	10,606	11,738	12,999
Household consumption (US\$ bn)	2,050	2,499	2,996	3,615	4,315	5,075
Household consumption per head (US\$)	1,560	1,890	2,260	2,710	3,210	3,760
Exports of goods & services (% change)	15.8	8.6	9.6	9.0	8.9	9.1
Imports of goods & services (% change)	14.0	10.0	10.5	12.3	12.0	11.1

Source: EIU 2011

The Chinese market



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Factors to considered U.S. Companies

- Selling goods in China is subject to various government controls, including:
 - Currency and exchange control
 - Invoice administration
 - Logistics arrangement
 - VAT implications
 - Corporate income tax implications
- A non-Chinese company is not allowed to buy from Chinese supplier and sell to Chinese customers directly because of the above mentioned control measures.
- Each region in China may have its unique interpretations of Chinese laws and regulations.

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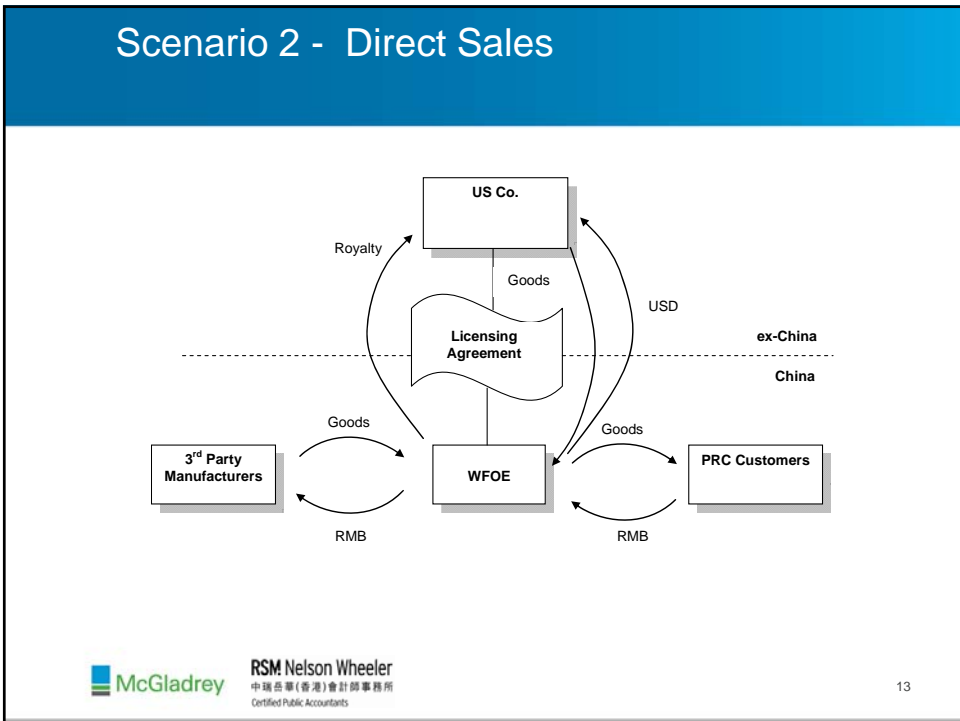
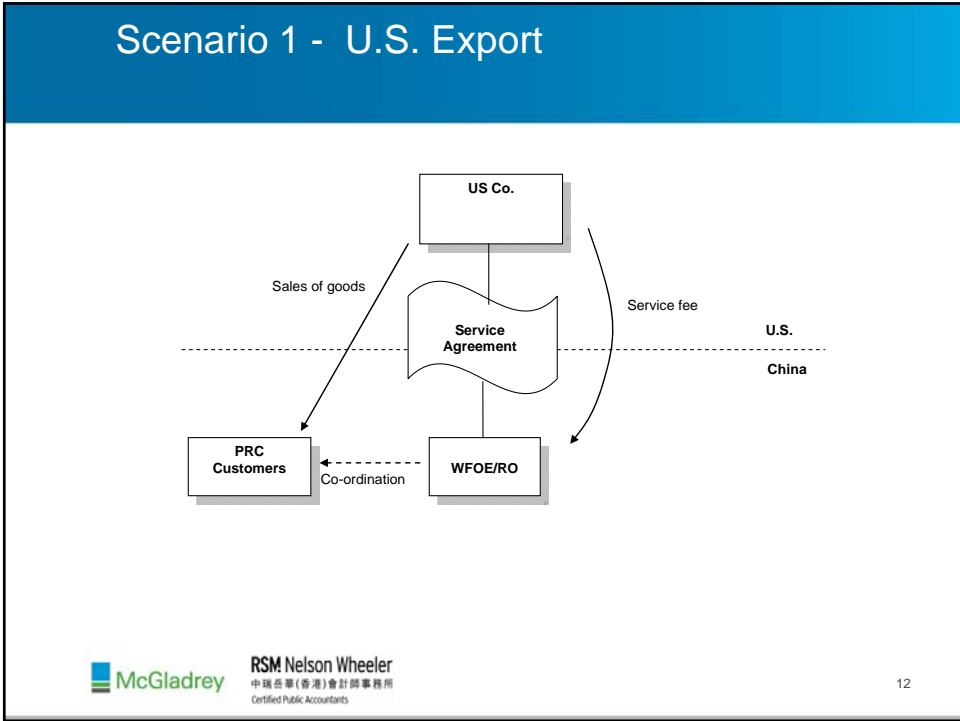
Possible Structures

Scenario	Supplier	Customer	Transaction currency	Structure
1 US Export	Outside China	China	USD	US Co. sells to Chinese customers direct, RO/WFOE as sales office
2 Direct Sales	China	China	RMB	Trading WFOE in China
3 Round-trip to Hong Kong	China	China	USD	US Co. sells to Chinese customers direct, goods to Hong Kong and then re-imported by Customers
4 Logistics Park	China	China	USD	US Co. sells to Chinese customers direct, goods to logistics park and then to Customers

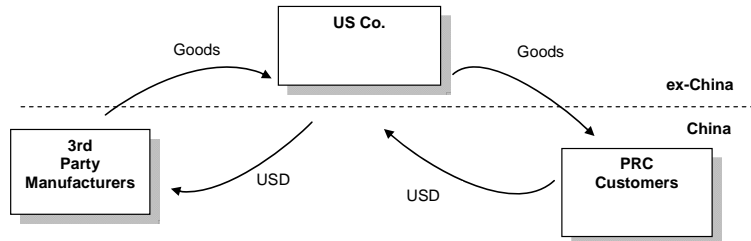


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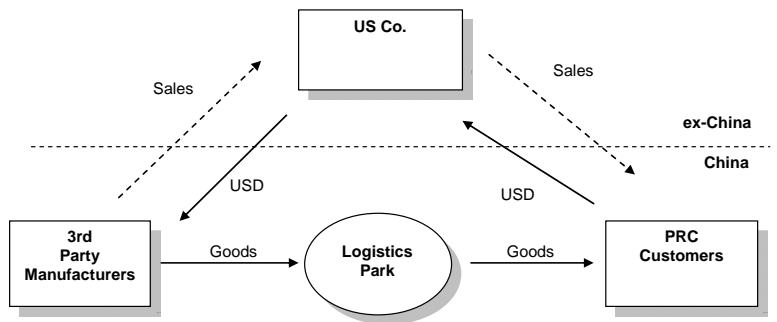
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Scenario 3 - Round-trip Hong Kong



Scenario 4 - Use of Logistics Park



Logistics Park

- Operators in PRC logistics parks could help to eliminate the needs of shipping goods out of China physically and re-importing into China.
- The operator could help the 3rd Party Manufacturers to declare exports and help the Chinese customers to declare importation of the goods by moving the goods into and out of a logistic park.
- Service fee will be charged by the operator, usually at 1% to 2% of the FOB value of the goods.

Common Logistics Parks


- Shenzhen: <http://www.szftz.gov.cn/Default1.aspx?ID=81&IID=1&ShowFlag=1>
- Zhangjiagang: <http://www.zjgftz.gov.cn/zjgftz/bsqwly/index.aspx>
- Ningbo: <http://www.nftz.gov.cn/>
- Dalian: <http://www.dleport.gov.cn/BSG/ALLData.aspx>
- Qingdao:
http://www.sdeport.gov.cn/homepage/InfoQuery/..%5Cmpages%5Czhuan_lan%5Cwuliu_yuanqu%5Cwuliu_index.htm
- Xiamen: <http://blp.xmedi.com.cn/>
- Tianjin: <http://www.tjftz.gov.cn/>
- Shanghai: <http://www.wblz.com.cn/>

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Comparison

	Scenario 1 US Export	Scenario 2 Direct Sales	Scenario 3 Round-trip to Hong Kong	Scenario 4 Logistics Park
Flow of goods	From US to China	Within China	Export to HK Re-import into China	Within China
Customs Declaration	PRC customs duty payable by Customer	N/A No PRC customs duty	PRC customs duty payable on re-import	Same as scenario 3
Flow of invoice	US to invoice to Chinese customer	WFOE to buy and sell	US Co. to buy and sell	US Co. to buy and sell
Flow of cash	USD	RMB	USD	USD
VAT	N/A	WFOE to pay VAT	Export VAT refund for 3 rd party manufacturers; PRC customers to pay customs duty and VAT	Same as scenario 3
Income Tax	US: 35%	WFOE: 25%	US: 35%	US: 35%

US Tax Issues: VAT and Custom can only be deducted. Whether the income tax is qualified for foreign tax credit will depend on the US company's global structure. Global transfer pricing will have impact on VAT, Custom, and income tax.



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PRC Tax Considerations

Tariff code	PRC Customs Duty – MFN Rates	PRC Customs Duty – Normal Rates	PRC Export VAT refund rate
7321110000	15%	80%	9%
7321190000	21%	80%	9%
8516609000	15%	130%	17%
8516299000	10%	100%	17%
7321810000	23%	80%	5%
7323990000	20%	80%	9%
8215990000	18%	80%	9%
8215200000	18%	80%	9%
7325109000	20%	90%	5%
7322900000	20%	80%	5%
7326909000	8%	90%	9%

PRC VAT (Scenario 2 only)

Assumptions

• Purchase price from PRC supplier	US\$500 plus VAT
• Selling price to PRC customer	\$720 plus VAT

Accounting entries of WFOE

	P&L	VAT A/C	Total
Sales	\$720	\$122.40	\$842.40
Cost of sales	(500)	(85)	(585)
Gross profit	220	-	-
VAT payable to tax bureau	-	37.4	(37.4)

PRC Customs Duty and VAT (Scenarios 3 & 4 only)

Assumptions

Purchase price from PRC supplier	US\$500
Selling price to PRC customer	\$600
PRC customs duty rate	20%
PRC customs duty payable	$\$600 \times 20\% = \120
PRC VAT payable	$(600 + 120) \times 17\% = \122.40

Total amount incurred by PRC customer: $(\$600 + \$120 + 122.40) = \$842.40$

Gross profit of US Co.: $\$600 - \$500 = \$100$

Other PRC Tax Issues for Scenario 2

- Net income of the WFOE shall be subject to 25% corporate income tax in China
- Royalty payment is generally capped at 5% of the WFOE's revenue
- Royalty payment is subject to 15% withholding taxes in China
- Dividend from the WFOE shall be subject to 10% withholding income tax in China

Summary – China Considerations

- The PRC customs duty rate (MFN rate) for most products range from 0% - 20%. For those products with high customs duty rate, Scenarios 3 and 4 would result in additional cost to the PRC customer.
- As the PRC export VAT refund rate for most of the products is below 17%, PRC suppliers would not mind selling to a WFOE direct provided that the selling price (excluding VAT) is the same as before.
- Under both Scenarios 3 and 4, US Co. would be considered as trading with China but not trading in China. As such, US Co. will not be subject to PRC taxes.
- In terms of logistics cost, it depends on the location of the suppliers and customers. Sometimes "Hong Kong round-trip arrangement" may be more cost effective than using a logistics park.

Summary - U.S. Considerations

- How will the Chinese structure fit in the U.S. company's global strategy?
- The business practice in China is vastly different than at home. There are a lot more registration requirements that will take time.
- Cash Flow Planning – It's difficult to get cash out of China
- Select the right entity treatment for US income tax purposes for the WFOE.
- Transfer pricing is a hot issue in both countries.
- Foreign Tax Credit eligibility
 - Enterprise income tax and withholding tax may qualify
 - VAT and business tax do not qualify

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***We will now answer your questions.
Please submit any additional questions
you may have at this time.***

Who to contact



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