

**BENEFITS AND COSTS OF SETTING UP A
 WHOLLY FOREIGN OWNED ENTERPRISE (WFOE)**

A COMPARISON WITH THE SETTING UP OF A REPRESENTATIVE OFFICE

The benefits and costs will be reviewed by way of comparison between a WFOE (commercial or trading company) and a Representative Office ("RO").

BENEFITS	WFOE	RO
Legal status	<ul style="list-style-type: none"> WFOE is an independent PRC legal entity, and WFOE will be legally responsible for all of its activities. 	<ul style="list-style-type: none"> RO is NOT an independent PRC legal entity, but rather a liaison office with a limited range of authorized activities. The foreign owner of the RO will be legally responsible for the activities of RO.
Conduct of business activities	<ul style="list-style-type: none"> WFOE may conduct business activities within the business scope of its business license as approved by the foreign investment approval authority and registered with the AIC; 	<ul style="list-style-type: none"> RO is prohibited from engaging in direct business activities. A RO can only observe market conditions. At most, a RO will be able to conduct business liaison for its investor, introduce products, conduct market research and carry out activities related to its own office administration;
Legal capacity to buy directly from factories	<ul style="list-style-type: none"> Yes. Therefore, there is no legal need to use agents, brokers and trading companies. Therefore, commissions or fees will tend to disappear. This requires the development of a direct commercial relationship with the factories. 	<ul style="list-style-type: none"> No, the RO can only buy from trade agents. Trade agents will normally: <ul style="list-style-type: none"> (i) charge a fee or commission; (ii) keep the drawback of the VAT (please see herein below)
Legal capacity to locally distribute in China (wholesale or retail)	<ul style="list-style-type: none"> Yes, after obtaining the applicable licenses. 	<ul style="list-style-type: none"> No, the RO can only observe market conditions.
Income Tax	<ul style="list-style-type: none"> Based on income (25%) 	<ul style="list-style-type: none"> Based on expenses

	<ul style="list-style-type: none"> Income in China can be efficiently managed (ref. reasonable transfer of prices) Expenses reduce income. All travel expenses related to China can be deducted from the taxable income. 	(10%)
Value Added Tax	<ul style="list-style-type: none"> Yes. Access to the Drawback of the VAT paid by exporters in purchase of products in China. The Drawback varies from 0 to 13% of the applicable VAT. The recent government policies are tending to give preference to products with more added value (i.e technological products). Consequently, the drawback of basic products or commodities is tending to 0. It is advisable to carry out a review of all the relevant products of a company to understand the practical consequences of this tax benefit. 	<ul style="list-style-type: none"> No access to the drawback.
Other Tax implications	<ul style="list-style-type: none"> If WFOE performs as an “expense center” only, the PRC taxing authorities may request an explanation on why no revenue is generated by WFOE. 	<ul style="list-style-type: none"> Tax will be imposed on the actual income generated, including amounts received by the investor that are attributable to RO. Annual activity reports should be filed within one month of the year-end if no income is generated. In our case, since RO is just an “expense center”, the income tax and business tax to be paid by RO may be nominal. The tax issue may not be a big concern of the taxing authorities unless they realize that RO actually

		engages in direct business activities by performing as a service center of investor in China.
Capital requirement	<ul style="list-style-type: none"> ● The minimum registered capital of a WFOE required by law is no less than RMB 30,000, but in reality the government requirement may be much higher than the minimum amount depending on the industry in which WFOE is involved and the feasibility study report of the WFOE; ● It is very hard to withdraw the registered capital invested in WFOE during its operation period; ● Any increase of registered capital is subject to government approval and AIC registration. 	<ul style="list-style-type: none"> ● No capital requirement.
Employment of foreign employees	<ul style="list-style-type: none"> ● WFOE may directly hire foreign employees by signing employment agreements with them; ● WFOE is not required to register its foreign employees (except GM, directors, supervisors, and legal representative) or any change of them with a competent administration for industry and commerce ("AIC"); ● There is no limitation on the maximum number of employees who may be hired by a WFOE. 	<ul style="list-style-type: none"> ● RO is NOT allowed to hire foreign employees either directly by signing employment agreements with them or indirectly through third party HR service providers (e.g. FESCO); ● The foreign owner of RO may appoint its foreign employees as the representatives of RO. Legally speaking, the representatives of RO are not the employees of RO, but of the foreign owner; ● All representatives and any change of them need to be registered with the AIC; ● There is no statutory limitation regarding the maximum number of representatives of a RO. However, if a RO has a good number of representatives and/or the representatives change

		frequently, the AIC may require reasonable explanations.
Application for work permit and residence permit for foreign employees	<ul style="list-style-type: none"> ● WFOE may apply for work permit and residence permit for any of its foreign employees; ● The entire application procedures may take 35-40 working days if everything goes smoothly. 	<ul style="list-style-type: none"> ● RO may apply for work permit and residence permit for any of its RO representatives; ● Compare with the WFOE scenario, it normally takes less time to complete the entire application procedures with respect to such an application.
Employment of PRC employees	<ul style="list-style-type: none"> ● WFOE may either directly hire PRC employees by signing employment agreements with them or indirectly employ PRC employees through third party HR service providers (e.g. FESCO). 	<ul style="list-style-type: none"> ● RO is NOT allowed to hire PRC employees directly by signing employment agreements with them BUT can hire PRC employees indirectly through third party HR service providers (e.g. FESCO).
Ability to protect strategic sourcing information (identity of the factories (that are used by the company).	<ul style="list-style-type: none"> ● Yes. Information on the original factories will not pass to clients or third competitors. Format F for Chile FTA can also be managed in order to protect the information. ● Additionally, it is easier to develop an information protection strategy by “fragmenting” the sourcing procedure. For instance using different factories for different pieces to thereafter ensemble in one of them or in a separate place. ● This “fragmentation” strategy can also be used to tackle the Format F issue with Chile. The factory that ensembles and appears in the Forma F will not be able to produce all the pieces. 	<ul style="list-style-type: none"> ● No. The names of the Chinese factory or the Chinese trading company will appear in all documents and registries, and therefore third parties or competitors will have access to this information.
Establishment time frame	<ul style="list-style-type: none"> ● It will take approximately 3-5 months in Shanghai 	<ul style="list-style-type: none"> ● Compared with WFOE establishment, relatively

	(time in other cities may vary) to complete the WFOE incorporation process, counting from the date of submission of all required documents for the application up to issuance of "Business License" by the AIC.	simple and comparatively short time frame required for setting up RO. Normally, the entire RO establishment process will take not more than 45 days in Shanghai (time in other cities may vary), counting from the date of submission of all required documents for the application up to the issuance of "Registration Certificate of Foreign Enterprise's Permanent Office in China" by the AIC.
COSTS		
Offices	<ul style="list-style-type: none"> No regulations. Costs should not differ from RO case. 	<ul style="list-style-type: none"> Only certain buildings that are allowed to house representative offices.
Human Resources	<ul style="list-style-type: none"> It should not differ from a RO. However, it normally includes more administrative staff especially for the handling of export documents. 	<ul style="list-style-type: none"> Depending on the size of the operations. 3 to 5 people is the average.
Accounting	<ul style="list-style-type: none"> Full accounting 	<ul style="list-style-type: none"> Simplified accounting
Legal Costs	<ul style="list-style-type: none"> USD10,000 to USD12,000 	<ul style="list-style-type: none"> USD3,000 to USD5,000