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The JLJ Group

China Market Entry Handbook

2011, 2nd Edition

About the author

The JLJ Group – Solutions for China Entry & Growth

The JLJ Group is a one-stop service provider assisting international companies in their mission to enter and grow in the China market. JLJ has already served more than 500 clients – including Fortune 500, SME's and government organizations - in more than 16 years of activity in China. JLJ provides services in five areas - Market Research & Consulting, Corporate Formation, Accounting, Recruitment, and Payroll &HR outsourcing – to support the business needs of foreign companies at different stages of their China projects.

Disclaimer: The information provided in this guide is intended for general reference only and is not an exhaustive survey of China's regulatory environment. Just as China's economy continues to change rapidly, so do the laws and regulations. The following information reflects the regulatory guidelines at the time of its writing and is not intended as advice to your specific circumstances.

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Growing at an outstanding annual rate of 9-10% for the last 25 years, together with its rapidly urbanizing population and bourgeoning middle class, the China market is one that foreign enterprises cannot afford to ignore.

At the same time, China presents a unique set of challenges for foreign companies keen to make inroads into the country. A complex tangle of government regulations, profound cultural differences with the "West", the size and diversity of the country, and its constant change and speed of development are just some of those challenges.

The intent of this China Handbook is to provide new market entrants with an introduction to China's unique business environment and a basic understanding of the most important aspects of doing business in China.

I Establishing a Legal Entity in China

China is notorious for its bureaucracy and the business registration process is no exception to the country's penchant for regulation. Unlike many other countries, registering a business in China may require the assistance of an agency authorized by the government to assist with the process. Prior to October 2004 companies were not allowed to register themselves but were required by law to use an authorized agent. With China's constantly changing regulations, inconstancies with interpretation and enforcement, and general lack of transparency, the process of properly establishing an entity to ensure against encountering problems in the future is far more complicated than in more developed markets. Engaging the services of a qualified consultant can substantially improve on chances of avoiding problems with compliance and decrease the time to get established.

1.1 Nature of the Investment

When a foreign investor decides to launch a business venture in China they will need to decide either to launch their business in the form of an actual capital investment or to start out more cautiously by scanning the market, building networks and using local representatives.

Foreign investors without a comprehensive understanding of the China market may wish to test the market first to see if it is worth it to establish a legal entity in China and invest a large sum of capital.

Foreign investors with more experience and understanding of the China market who intend to conduct a full range of business activities should consider establishing a legal entity. In the case that a legal entity is preferred, the form of the entity chosen is quite crucial. Aspects that have to be considered are the sector of business and amount of money invested, as well as if a Chinese partner is desirable or even mandatory for the business, along with other general commercial and strategic considerations. In addition to the level of financial risk and control a company prefers for its China operations, government restrictions on specific industries affect the investment type made. Media, automotive and telecom industries are examples of industries that require foreign invested enterprises to have local partners.

A **Representative Office (Rep. Office)** represents the interests of the foreign investor by acting as a liaison office for the parent company. Rep. Offices may conduct market research, develop partnerships and business channels; however, all business transactions, including issuance of invoices, are managed by the parent company. Furthermore, Rep. Offices may not directly hire local employees but must rely on a government-authorized employment agency. Since Rep. Offices do not have a minimum investment requirement, they are not considered a Foreign Invested Enterprise. Rep. Offices are the least complicated way for a foreign firm to have a legal presence in China and are often the choice for foreign companies with little or no previous experience in the country. However, given the restrictions on direct employment of local employees, transactions and taxation on expenses, Wholly Foreign Owned Enterprises may be a better option for entrants seeking to develop their business domestically.

Wholly Foreign Owned Enterprise (WFOE), the most popular Foreign Invested Enterprise (FIE), is a limited liability company fully invested by one or more foreign investors. Along with the rights afforded to a Rep. Office, a WFOE may also legally conduct business transactions within China and hire local employees on its own accord. However they do have a minimum investment requirement that is dependent upon the locality and nature of the business. WFOEs are becoming more and more common and have begun to outpace Joint Ventures as the most popular vehicle for a China presence.

Equity Joint Venture (EJV) companies have capital investments from both local and foreign firms. The percentage of the capital investment determines the amount of profit and risk that both the foreign and local company assumes. Foreign firms entering industries where WFOE's cannot operate often use JV's although this is becoming less prevalent as more and more industries begin to gradually open up to WFOE's.

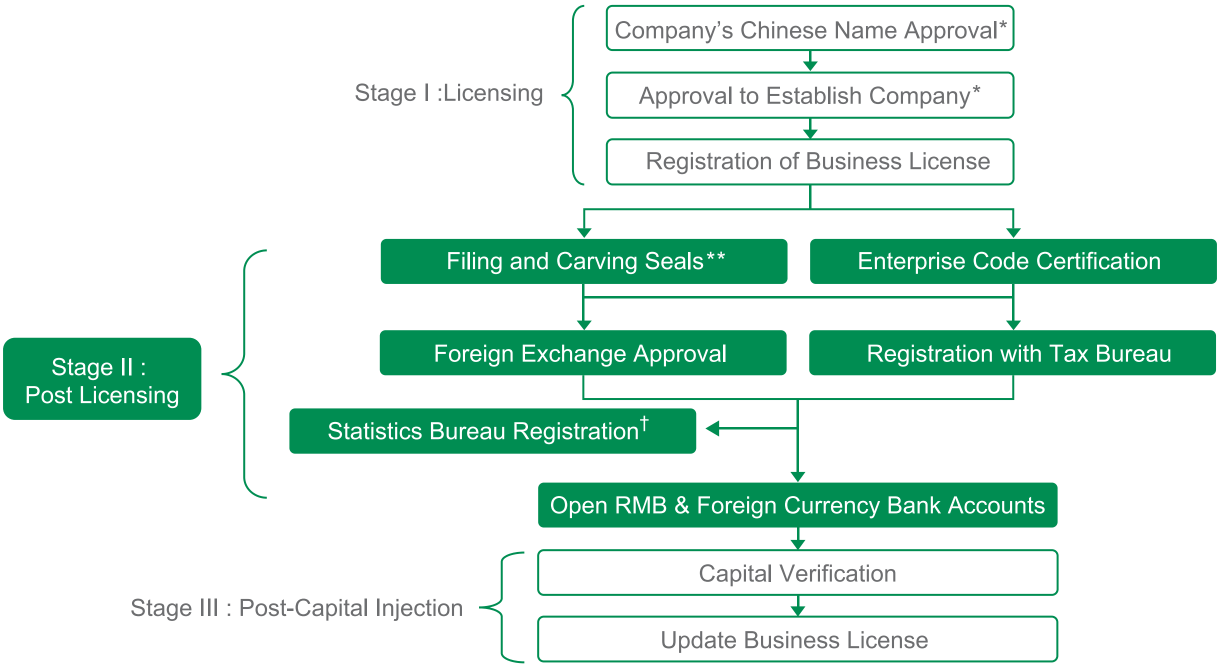
The risk associated with entering into partnerships with other companies applies in China and is often exacerbated by disparities in culture and business practices between the foreign and local partners. Foreign Companies should enter into JV's only when both parties have reached a clear understanding of the business objectives and appropriate exit strategies have been developed.

Cooperative Joint Ventures (CJV) are also partnerships with a local company; however, the amount of risk and profit shared by each party is not determined by capital investment but rather agreed upon at the beginning of the partnership. CJVs were used more in the 1990's when the Chinese economy was not as developed. International companies often injected funds while the local Chinese companies provided equipment and other necessities. Laws and regulations can vary substantially between industries and procedures vary accordingly.

Recent years have shown a trend towards investing in China through mergers & acquisitions (M&As). There are many options for M&As in China, including equity and asset acquisitions as well as mergers. As a form of foreign direct investment, the general rules on establishment of FIEs also apply to M&As.

1.2 Registration Steps

Below is the typical process for setting up both foreign invested enterprises and Rep. Offices. The government offices involved in this process include the Ministry of Commerce, the Administrative Bureau for Industry and Commerce, State Administration of Foreign Currency, Taxation Bureau, the Customs Office, and the Statistics Bureau.



** These steps are not required for the establishment of a Rep. Office*
*** Official company stamps required for many business and banking transactions in China*
† This process is usually completed following foreign exchange approval and registration with the tax bureau

1.3 Registered Capital

FIEs - WFOE's and JV's - require the foreign investor to establish a minimum amount of funds from abroad within China, called Registered Capital. The amount of registered capital must be declared during the licensing phase of the registration process. The total investment figure is represented by a ratio between foreign contributed capital and debt. The registered capital should cover all the initial investment expenses that the foreign entity will have and may be used immediately for the newly formed company's expenses. This may include paying rents, salaries and purchasing products, etc. It is considered a felony to state a specific amount of funds and then not contribute. It is also a felony to inject the funds as stated and then withdraw the injection. One purpose of the registered capital is to provide confirmation to creditors of the company's financial adequacy.

Total Investment	Registered Capital
Less than 3 million	No less than 70% of total investment, with a minimum of 3,700
Between 3 and 10 million	No less than 50% of total investment with a minimum of 2.1 million if total investment is below 4.2 million
Between 10 and 30 million	No less than 40% of total investment with a minimum of 5 million if total investment is below 12.5 million
Between 30 and 36 million	No less than 1/3 of total investment with a minimum of 12 million

Injection Terms

- Complete Injection within 6 months or:
- Capital Contributed at different periods (must inject at least 15% of the registered capital in three months after issuance of business license): The remaining amount of money is to be injected by companies in 2 years time, with the exception of a holding company, which is required to do so within 5 years.

Currency: US Dollars

In theory most small to medium sized companies entering the market are required to invest a minimum of US $3,700 (RMB 30,000) for a multiple investor WFOE. In practice, however, this kind of a capital injection would rarely cover the start up expenses of any company. Furthermore, in order to receive government approval the required amount is usually substantially more. Overall it can be stated that the investment required is dependent upon the scope of business, volume of sales, company size, location of setup and judged on a case by case basis. Chinese authorities will consider what would be a reasonable capital injection for each specific project in question.

1.4 Nature of the Business

For Foreign Invested Enterprises - WFOE's, EJV's and CJV's - must declare the nature of their business during the licensing phase of the registration process. The intended scope of operations in China and the capital investment the company is willing to make determines the category of business that a foreign company declares. The following categories are by far not exhaustive but represent the most common forms of foreign invested enterprises operating in China today. Other categories of business include Purchasing Centers, Research and Development Centers, Investment (Holding) Companies and Regional Headquarters.

Service Company

As the name implies, the foreign firm provides services to either companies or consumers. In most cases, the Company may not manufacture or trade goods. Examples of service companies include consulting, training, restaurants and management service companies.

Manufacturing Company

The nature of this business allows the foreign company to produce goods for sale on premises as well as sell finished goods domestically and internationally. Manufacturing companies do not require an intermediary to sell goods locally or internationally and may import raw materials for production. The registration process, however, might be more complicated than other business categories as manufacturing plants may require additional certifications.

Foreign-Invested Commercial Enterprise

A FICE allows foreign companies greater flexibility in terms of business activities. These activities include retail, wholesale and franchising operations. Once established, a FICE is granted both import and export rights. FICEs may also buy and sell products freely in China without an intermediary. It is also possible for manufacturing FIEs to apply to extend their business scope to include FICE capabilities and vice versa.

As foreign companies entering the market begin to navigate the bureaucratic landscape, having a clear understanding of the investment and business options available will be crucial to successfully establishing a business and operating in China. With China's gradual compliance with its WTO membership obligations, the business registration process should also continue to improve while more industries are open to foreign investment.

When choosing a business registration agency, foreign companies should consider the agency's knowledge of recent policy changes, transparency on the registration process and its track record of successful registrations. Selecting an appropriate service provider that can effectively guide foreign investors through the complicated process will go a long way in insuring a smooth entry into the market.

A detailed summary of entity types and their respective allowed business scope, tax treatment and registration process can be found on the next page:

Legal Entity Comparison Chart

	Business Activities *						Registration Process					
	Import	Export	Domestic Commercial Activties	Service Activities	Manufacturing / Assembly Rights	Tax Treatment	Min. Registered Capital**	Duration of Entity†	Potential for Future Expansion of Scope‡	Registration Complexity	Aprox. Time to Register#	Notes
Representative Office	🔴	🔴	🔴	🔴	🔴	🔴¼🟢¾	N / A	1 year	🔴	🟢	1 Month	• Cannot Issue Invoice (no Transactions) • Intended for Market Research and Business Development Activites • Cannot directly hire Local Employees • Taxed on Expenses (aprox.10.9 %)
Foreign Invested Enterprises: Service	🔴	🔴	🔴	🟢	🔴	🔴½🟢½	30,000RMB	30 years	🔴½🟢½	🟢	2 Months	• Products may only be sold coupled with services
Foreign Invested Enterprises: Manufacturing	🔴½🟢½	🔴¼🟢¾	🔴½🟢½	🔴½🟢½	🟢	🔴¼🟢¾	30,000RMB	30 years	🔴½🟢½	🔴½🟢½	3 Months	• Distribute products manufactured in-house • Additional time may be needed for special licenses
Foreign Invested Enterprises: In't Trading	🔴½🟢½	🟢	🔴¾🟢¼	🔴¾🟢¼	🔴¾🟢¼	🔴½🟢½	30,000RMB	30 years	🔴½🟢½	🟢	2 Months	• Must be registered in a Free Trade Zone • May require Import/Export agent for import activities • Expansion to Manufacturing & FICE available
Foreign Invested Enterprises: FICE	🟢	🟢	🟢	🔴½🟢½	🔴¾🟢¼	🔴½🟢½	30,000RMB	30 years	🟢	🔴½🟢½	2 Months	• May be authorized for Retail and / or Wholesale • Franchising and Direct Selling available through approval • Commercial Activities are limited to like products
Foreign Invested Enterprises: FICE+Manufacturing	🟢	🟢	🟢	🔴½🟢½	🟢	🔴¼🟢¾	30,000RMB	30 years	🔴¼🟢¾	🔴½🟢½	3 Months	• Tax incentives at risk if production is less than 50% of total revenues
Specialized Corporate Formations												
Investment Holding RHQ	🟢	🟢	🔴¾🟢¼	🟢	🔴	🟢	30,000,000USD	50 years	🔴½🟢½	🔴¾🟢¼	6 Months	• Provides management & corporate services to investments • Incentives can be negotiated with local govemment • M&A Activitles are allowed • May include R&D center
Management RHQ	🔴	🔴	🔴	🔴¾🟢¼	🔴	🔴¼🟢¾	2,000,000USD	50 years	🔴¾🟢¼	🔴½🟢½	3 Months	• Limited management and corporate services for investments • Incentives can be negotiated with local govemment (but not as optimal as Investment RHQ)
R&D Center	🔴	🔴	🔴	🔴¾🟢¼	🔴	🟢	2,000,000USD	30 years	🔴¾🟢¼	🔴¾🟢¼	3 Months	• Incentives may be negotiated with local govermment • Must maintain a minimum of 80% of staff with advance degree

🟢 =Ideal

🔴 =Prohibited

*Denotes activities that may generate revenue streams for the entity.

**This reflects the minimum as stated in China's Company Laws and does not guarantee approval.

† This reflects the maximum duration the entity may be approved by the goverment. All entities' licenses may be renewed before expiration.

‡ Capability of the entlty to expand to include additional capabilities (i.e.,Manufacturing entity expands to include FICE capabilities; Distribution FICE expands to include franchising and retail)

Approximate Time refers to the time required to obtian the license, commencing only upon the complete collection of all required documents

2 Taxation of Foreign Enterprises in China

Foreign companies that engage in business operations in China are required to pay taxes according to the Chinese tax laws. The most commonly used forms of business for foreign companies are the Representative Office (Rep. Office) and the Limited Liability Company (LLC). The most important tax categories for these forms of businesses are **corporate income tax** and **business tax**. For industrial, commercial and trading companies the **value-added tax (VAT)** is a major tax liability as well. The main taxes for foreign businesses in China and their methods of calculation will be discussed in this guide.

2.1 Tax Registration and Tax Entry

After the business license is received, a Representative Office or a Limited Liability Company (LLC) must register at the relevant tax authorities within 30 days time. This includes both the national taxation bureau and its municipal branch; however, only one application has to be handed in. Generally, the application process takes 10 working days. Companies are not required to hire an authorized agent for this process and can apply themselves. However, if the investor has used a registration service provider for the registration of the Rep. Office or a Limited Liability Company, this tax application service will often be included in the service.

2.2 Main Tax Categories for Foreign Enterprises

Corporate Income Tax

Corporate income tax is levied on income of LLCs derived from production, business operations and other sources within and outside China[1]. LLCs have to pay this tax quarterly, and the applicable tax rate is at 25%. The method of computation is as follows:

Tax payable = [Total Annual Income – Expenses – Losses] x Applicable Tax Rate

Business Tax

The business tax is a turnover tax paid on the revenue of certain services such as communications and transportations (applicable tax rate of 3%), construction (3%), finance and insurance (5%), posts and telecommunications (3%), culture and sports (3%), entertainment (5-20%), sales of buildings within China (5%) and other services[2] (5%). Furthermore, there is an indirect tax surcharge on top of business tax such as education (3%), river maintenance (1%) and city construction (7 to 1%) (which raises the effective tax rate from for example 5% to 5.55%). LLCs are required to pay this tax monthly. The tax payable is computed as follows:

Tax payable = Business Turnover x Applicable Tax Rate

Withholding Tax

Non-resident enterprises are subjected to a 10% withholding tax at source. Some scenarios where withholding tax applies include:

- Dividend payment to non-resident parent company
- Interest, rent, royalties, management fees paid to non-resident foreign enterprises
- Net capital gains from transfer of shares or equity interest in FIE-held enterprises
- From 1st September 2009, payment of contracted projects and services to non-resident enterprises will be subjected to withholding tax

1. However, if a company is not registered in China, it only has limited tax liabilities for all revenues generated from within China. The applicable corporate income tax rate for this kind of company is 10%.
2. This last category includes hotels and travel agencies, restaurants, rent agencies, advertisement companies, consulting businesses, etc.

The payer is required to withhold the tax payable from the payment to be remitted to the non-resident enterprise and submit it to the tax authorities.

There are however several countries that have signed tax treaties with China and offer reduced withholding tax rates. Examples of such countries include Hong Kong, Singapore, Mauritius, Barbados, Switzerland, etc. Foreign investors may be able to enjoy these reduced tax rates if the local entity is structured underneath a parent company located in one of these countries. As of early 2009, however, China has issued a number of anti-avoidance circulars that may require the parent company within one of these jurisdictions to prove that it is a substantive business before the local China entity may enjoy the benefits of these tax treaties.

Stamp Tax

Contracts and related documents are subject to a stamp tax. Different tax rates are applied to different types of contracts, for example the purchasing and distribution contract will have a 0.03% tax of the total revenue. The stamp tax ticket will be attached to the contract when the contract is signed.

Housing Tax

A housing tax of 1.2% of the purchase value of properties has to be paid twice a year, in May and November. This tax only applies to owned property.

Vehicle and Vessel Tax

Users of vehicles and vessels are subject to payment of vehicle and vessel usage license tax. Tax on vessels and trucks is levied according to tonnage, while tax on passenger cars is levied according to the type of vehicle and the number of seats. This tax has to be paid twice a year, in May and November.

2.3 Taxation of a Representative Office

As Rep. Offices (excluding those engaged in business consulting, legal matters, accounting etc.) are not allowed to generate revenue, their tax base for corporate income tax and business tax is presumed on the basis of their expenses. In China, a minimum presumed profit rate of 15% is used for calculation[3]. However, the tax base for the business tax is the amount of the expenses incurred. To make this clear see the following example.

Formulas:

Presumed Income Amount	**=**	**Operations Expense / [1 – Pres. Profit Rate 15% – Business Tax Rate]**
Business Tax Payable	**=**	**Income Amount x Business Tax Rate 5%**
Corp. Tax Payable	**=**	**Income Amount x Presumed Profit Rate 15% x Corp. Tax Rate 25%**

Example:

A	B	C	D	E	F	G	H
Operations Expense	Presumed Profit Rate	Business Tax Rate	Corp. Tax Rate	Income Amount A / [1 - B - C]	Business Tax Payable E x C	Corp. Tax Payable E x B x D	Total Tax Payable F + G
8,000	15%	5%	25%	10,000	500	375	875

The result of this relatively complicated computation is an estimated 11% tax on operation expenses, which can be used as a rule of thumb. Unlike LLCs which pay their taxes on a monthly basis, Rep. Offices pay both the business tax and the corporate income tax quarterly.

3. *This method of calculating tax liability for Representative Offices is applicable in Shanghai and Beijing. It is possible that the minimum presumed profit rate could be determined on a case by case basis.*

2.4 Tax Incentives

Many foreign companies, registered before March 16th 2007, enjoyed preferential tax treatment if they were located in special economic zones or if they were involved in production-oriented businesses. However, with the implementation of the new income tax law from January 1st 2008, such preferential tax treatment is no longer available, and companies currently enjoying reduced tax rates will see their income tax rate gradually raised to the standard 25% by 2012.

However, some tax incentives remain for certain industries and projects that are encouraged by the state. Below are some examples:

Example:

Industries/Projects	Tax Rate
Certain Advanced and New Technology Enterprises	15%
Certain small-scale enterprises with low profitability	20%
Income derived from - certain agriculture, forestry, animal husbandry or fishery projects - certain investment in or operation of certain public infrastructure projects - qualified environmental protection and conservation projects - certain technology transfer projects - offshore outsourcing	Tax exemption or reduction
Enterprises located within certain ethnic autonomous regions (subject to approval from the People's government of the relevant regions).	Tax exemption or reduction

2.5 Value-Added Tax (VAT)

a. General and Small-Scale Taxpayers

The Chinese tax system distinguishes between general and small-scale payers of VAT (see chart below). Small-scale taxpayers are enterprises with annual taxable value of sales below the prescribed limits, namely RMB 500,000 for manufacturing and service companies, and less than RMB 800,000 for those engaged in wholesaling and retailing. VAT has to be paid on a monthly basis and special VAT invoices must be bought from the tax bureau.

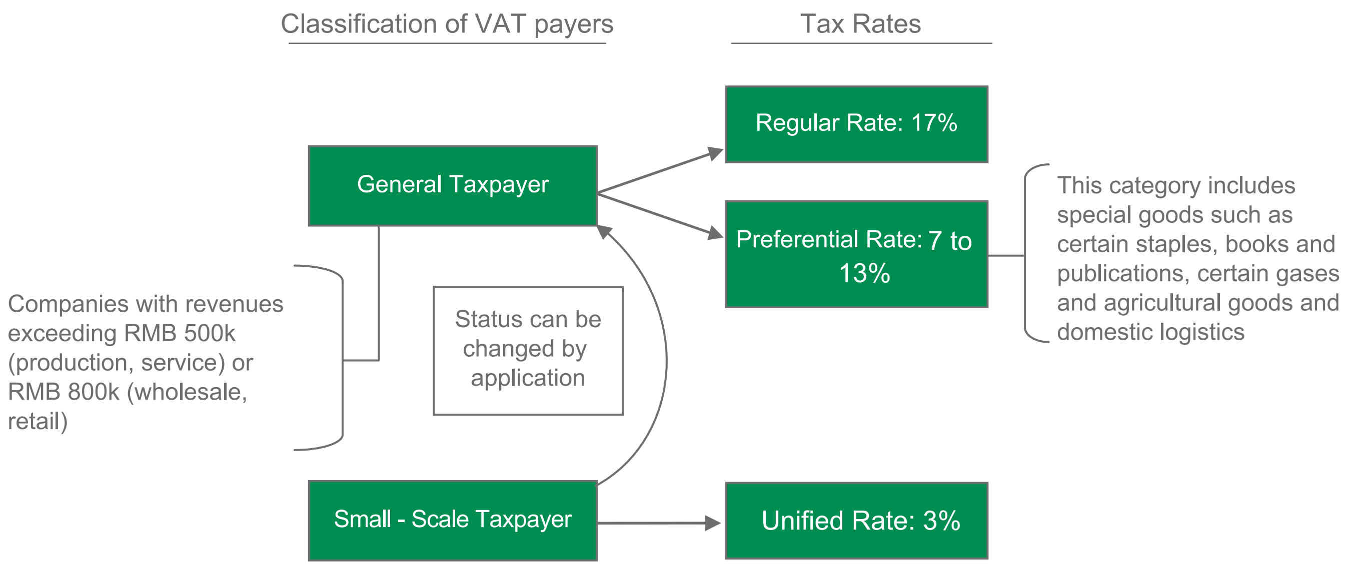
b. General VAT Taxpayers

The actual amount of VAT payable by general VAT taxpayers is the excess amount of output VAT over input VAT. There are two applicable tax rates, a basic rate of 17% and a lower rate of 13%[4]. The formula is as follows:

Tax Payable = Current Output VAT – Current Input VAT
Output VAT = Sales Volume x Applicable Tax Rate

If the current output VAT is smaller than the current input VAT, the amount that cannot be fully offset or deducted may be carried over to subsequent tax period(s).

4. *The sale and import of the following commodities are subject to the lower VAT rate: grains, edible vegetable oil, drinking water, heating, air-conditioning, hot water, coal gas, liquefied petroleum gas, natural gas, methane, coal products for domestic use, books, newspapers and magazines, foodstuffs, chemical fertilizers, pesticides, agricultural machinery*



c. Small-Scale Taxpayers

VAT payable by small-scale taxpayers is calculated by a simple method on the basis of the overall sales value and the tax rate without deduction of input VAT. This means the input VAT borne by small-scale VAT-payers (through purchasing goods from general taxpayers) is not refunded by the tax authorities. Furthermore small-scale taxpayers do not have to pay VAT on the value of exported goods. The applicable tax rate is 3% for commercial as well as manufacturing enterprises. The formula is as follows:

Tax payable = Sales Volume * 3% / (1+3%)

d. Consumption Tax

Consumption tax is payable on the sales value of certain consumer goods. This includes 11 general items: cigarettes, alcohol, cosmetics, fine jewelry, precious stones, firecrackers, gasoline, diesel oil, motor vehicle tires, motorcycles, and small motor cars. The applicable tax rates range from 3% to 50% and the tax is paid on top of VAT. The producers include the tax in the price of the products meaning that the tax is ultimately borne by consumers. Retailers and wholesalers are not required to pay consumption tax when they trade goods of this category. Also consumption tax is fully rebated for exported goods.

e. VAT on Exports

Generally the value of exported goods is exempt from VAT and consumption tax. Companies can apply for the tax rebate at the relevant tax authorities after the goods have left Chinese territory and if all payments are completed within three months after the end of the year. The official customs declaration must be attached to the application. Small-scale VAT paying companies can not apply for the tax rebate and are only exempt from VAT when they export goods. The formulas for calculation of the rebate amount are as follows:

Tax Payable = Domestic Output VAT – [Input VAT for Total Purchases – Non-Refundable VAT]

Non refund VAT = Export Sales x [VAT Rate – Refund Rate]

Note that the rebate rate for certain goods can be smaller than the VAT rate, which means that the full amount paid as VAT on exported goods will not be refunded. To understand the process of the VAT rebate calculation, see the following example. The VAT and the rebate rate are 17%. The tax payable is negative meaning that it will be refunded.

Example:

A	B	C	D	E	F	G
Total Purchases	Input VAT A x 17%	Domestic Sales	Export Sales	Domestic Output VAT C x 17%	Non refund VAT D x (17%-17%)	Tax Payable E - [B - F]
3,800,000	646,000	2,000,000	3,000,000	340,000	0	-306,000

f. VAT on Imports

However, there is a tax on imported goods, which is calculated as follows:

Tax Payable = VAT Rate x [Dutiable Value + Customs Duty + Consumption Tax]

The dutiable value of imported goods includes the purchase price and the transport and insurance cost. See the example with the VAT rate of 17%, a consumption tax rate of 3% and the customs duty of 12%:

Example:

A	B	C	D
Dutiable Value	Customs Duty A x 12%	Consumption Tax [A + B] x 3%	Tax Payable (A + B + C) x 17%
120,000	14,400	4,032	23,533

2.6 Annual Audit and Annual Examination

Both Rep. Offices and LLC's are required to be audited on an annual basis. The annual audit has to be filed before the end of March of the following year. The annual audit of Rep. Offices and LLC's must be conducted by a firm of Certified Public Accountants (Chinese or foreign JVs) registered in the PRC under PRC regulations. LLC's must also undertake an annual examination whereby they submit various certificates and financial documentation to local authorities for their inspection.

The chart below summarizes the obligations of both the Rep. Office and the LLC with respect to payment dates and deadlines.

Tax Timeline:

Entity Type	Rep. Office	LLC
Tax Registration	within 30 Days After License Approval	
Income Tax	Quarterly	Quarterly
Business Tax	Quarterly	Monthly
VAT & Consumption Tax	N/A	Monthly
Housing & Vehicle Tax (deduct Stamp Tax)	May & November	
Annual Audit & Clearance	End of May	
Annual Examination	End of June	

2.7 Profit Repatriation

Foreign companies may only distribute and repatriate profits back to their investors after completion of the annual audit, the settlement of their relevant income tax liabilities and all losses are made up, which were carried forward from previous years. In addition, the WFOE must set aside a minimum 10% of after-tax profits into a reserve fund until the accumulated reserve fund reaches 50% of the registered capital. The remaining part is distributable profits from which the board of directors may declare dividends to the investors in proportion to their contribution to the registered capital. Once the accumulated reserve fund threshold of 50% is reached and maintained, the FIE may repatriate all profits to their home country. The mandatory reserve fund ensures that a portion of the profits are being re-invested into the FIE.

3 Recruitment in China

China's rapid economic growth has resulted in an increasingly fragmented society. Traditional values are still at the core of Chinese culture; however, personal ambition and the desire for acknowledgment of achievement are beginning to define behavior, in particular within the younger generations. Consequently, many foreign companies face difficulties recruiting and retaining staff in China.

3.1 Current Trends in the Chinese Labor Market

High Turnover Rates

Observation: It is increasingly common for Chinese employees to switch jobs every few years.

Fact: Young Chinese are very competitive and are always looking for career progression opportunities to better position themselves in the global market. Hence, they tend to welcome headhunters and do not hesitate to take up better offers.

Outcome: Talent is easily accessible if one has the relevant contacts. However, it remains generally hard for employers to retain these talents in a single company for long-term commitment.

Increasingly Competitive Salaries[5]

Observation: Salaries are generally becoming more competitive in China. In particular, salaries in 1st-tier cities are approaching levels found in other more developed countries.

Fact: The phenomenal economic growth of China has led to a rapid rise in salaries for managerial and higher positions. This is in contrast to the very stable and generally stagnant salaries found in developed countries.

Outcome: Cheap labor is disappearing in China for managerial positions and higher positions, especially in 1st-tier cities.

Prevalence of Younger Upper Management

Observation: Managerial and higher positions are increasingly held by young individuals. In fact, many directors of corporations in China are only in their early thirties.

Fact: Due to the Chinese economic reform in 1978, education standards have improved drastically over the past years. This has resulted in a great disparity in knowledge and capabilities between the young and old, especially in terms of English competency levels. This has thrown off the conventional thinking that senior candidates are always more capable than their younger counterparts.

Outcome: Highly educated young Chinese are now possible candidates for managerial and higher positions in China and such positions are no longer necessarily held by senior employees.

5. 1st tier cities refer to Shanghai, Beijing and Guangzhou; 2nd tier cities refer to Chongqing, Dalian, Hangzhou, Nanjing, Ningbo, Qingdao, Shenzhen, Suzhou, Tianjin, Wuhan, Xiamen, Xi'an and Zhuhai.

3.2 Rules of Thumb for Hiring Managers in SMEs:

1. **Look for passively available candidates for important positions**

   Passively available candidates tend to be highly capable individuals who are not threatened by the possibility of retrenchment. This is different from active job seekers who may have been retrenched due to performance-related issues. This is particularly important for positions that are responsible for a company's profits and losses. Hence, companies are advised to be careful of being tempted by the extremely convenient and active online recruitment services in China. Instead, professional recruiters should be engaged to source for and recruit quality candidates from other companies.

2. **Expect to pay a premium for proficient users of English**

   Due to the great disparity in English competency levels existing in China, candidates strong in English can easily command premium salaries that are 30% higher than the average employee. This is partly due to the high demand for such candidates from multi-national corporations (MNCs).

3. **Do not depend solely on phone interviews when hiring in China**

   Phone interviews provide insufficient information for screening candidates. There have been cases of deceit in phone interviews where candidates engaged external help to ace through interviews without actually possessing the required competencies. So it becomes hard to assess the qualities and reliability of a person through a simple phone call. Hence, companies should always conduct face-to-face interviews for better evaluation of candidates and prevent the occurrence of frauds.

4. **Do not negotiate directly with candidates if you are unfamiliar with their cultures**

   This is particularly true for sensitive issues such as salary negotiations. Miscommunications tend to occur in such negotiations due to cultural differences in expression. This has repeatedly resulted in foreign companies dismissing good candidates prematurely. Hence, companies should always negotiate salaries and other sensitive issues via experienced recruiters or HR professionals who are familiar with the local culture.

5. **Keep in touch with selected candidates**

   Chinese candidates have very strong desires to succeed in the global economy. Hence, it is not uncommon to find them continuing to search for better opportunities despite having accepted an offer. Thus, it would be wise for hiring managers to keep in touch with the selected candidates and take note if they are still keen and available to join the company. This will help to avoid unnecessary surprises when the candidate fails to show up on the first day of work.

6. **Hire candidates from the vicinity if your office is located in 2nd/3rd tier cities**

   Foreign SMEs have been found to prefer candidates from 1st tier cities despite having their offices located in 2nd or 3rd tier cities. This is because these candidates are more likely to be able to relate easily to their employers in terms of both language as well as their expectations for standards of living. However, such candidates may find it difficult to adapt to the poorer living conditions of the lower tiered cities. This can eventually lead to high employee turnover rates and become detrimental to the company.

7. **Place greater emphasis on core competencies in 2nd/3rd tier cities**

As English proficiency levels tend to be lower in 2nd and 3rd tier cities, it may be difficult to locate candidates who are both good in English and have the required competencies. One way to work around this is to hire candidates with English majors and train them in the relevant skill sets. Alternatively, companies can hire candidates based on the required competencies and leave the linguistic requirements to a specialized role within the company.

3.3 Engaging a Professional Recruiter

Employers are advised to engage professional recruiters when sourcing for specific talents to fill important positions. In particular, they can help ensure the timely arrival of suitable candidates who are committed to and interested in pursuing the opportunity. This avoids the dire consequences of leaving such important positions vacant for extended periods of time.

Methodology

The key differentiating factor between a professional recruiter and an amateur lies in the methodology adopted in their search for candidates. Professional recruiters are in control of the entire process. They understand the specific needs of their clients and are able to accurately identify a best-fit candidate in the shortest possible time. In contrast, amateurs are heavily reliant on the quality of resumes they receive and may not be able to perform when faced with unfamiliar industries.

In particular, many professional recruiters use a precise search process called the ***Social Networking System (SNS)***. It helps recruiters to narrow down and identify potential candidates efficiently via recommendations from one's contacts in the relevant industry. The process is then repeated for several degrees of separation until a best-fit individual emerges from the recommendations. Nonetheless, this is a complicated process and requires many years of experience in headhunting as well as in-depth knowledge of niche areas in specific industries to be effective.

Other Factors

Besides methodology, intangible soft-skills are also critical in headhunting. These are important factors that must be considered when evaluating the professionalism of a recruiter.

- **Network**
  This determines the range of coverage in an executive search service. However, it does not necessary mean that a wider search is always better, as in-depth knowledge of a specific labor market may have been compromised for greater coverage. Hence, the suitability of a recruiter's network depends on the job requirements and where such candidates can be found.

- **Persuasion Skills**
  Best-fit candidates may be passively-available instead of being actively engaged in job-hunting. In other words, they are still employed and may require substantial persuasion to leave their established portfolio. Hence, a recruiter's ability to motivate a candidate to explore new opportunities is a crucial, final step in headhunting. Moreover, the way an offer is positioned in terms of career development will also affect a candidate's commitment to the client company after the end of the probation period.

Hence, it is important to engage a capable recruiter, especially for positions that are hard to fill. Otherwise, mismatches may occur repeatedly, wasting both time and effort of all parties involved.

4 Employing Local Personnel in China

The employment of staff is a fundamental issue for companies entering china. What rules and regulations apply for the setting up of a labor contract? How do employees and employers pay social benefits and taxes? What are the differences between employing locals and foreigners? As Representative Offices aren't allowed to hire local staff directly, how can they employ staff? How can HR outsourcing contribute to solve these issues? These are examples of questions puzzling companies as they begin the hiring process.

Generally, apart from common employment requirements, such as signing contracts with workers, meeting wage standards and issuing salary in a timely manner, employers in China are also obliged to:

a. File their staff employment and dismissal with relevant government bureaus
b. Maintain employees' personnel file – a unique Chinese document that records all academic and employment history of an employee, and the responsibility of maintaining the records is transferred from one employer to another when the employee changes jobs
c. Withhold and pay individual income tax on behalf of their employees
d. Make monthly contributions to their employees' social benefits and housing funds

Most of the above processes are complicated by the involvement of several government bureaus and tedious paperwork. For the unfamiliar, staffing their China operations may pose a challenge and many choose to rely on service providers and HR specialists to guide them through these HR administrations.

4.1 The Employee Contract

Under the People's Republic of China's (PRC) Labor Law, all companies are required to sign employment contracts with their employees. While limited liability companies are allowed to sign employment contracts directly with local PRC staff, a representative office must engage authorized service providers to hire and dispatch the representative office's local employees.

While there is no standard contract form, the agreement should include:

- Term of contract & Probation period
- Job title and description
- Labor protection and working conditions
- Compensation
- Termination conditions
- Breach of contract provisions & disciplinary rules
- Other provisions such as Training Bond, Non-disclosure agreement and Non-compete agreement

4.2 The Employee Personnel File & Staff Handbook

Every employee in China owns a personnel file and a proof of employment history. The personnel file details the employee's education and employment history, and the responsibility of maintaining this file is transferred from one employer to the next when the employee changes jobs. Unlike the personnel file, regulations on the proof of employment history vary across regions. For Shanghai and Beijing, employers must withhold the employees' staff handbooks during the employment period. Rep. Offices, which are not allowed to hire local employees directly, must engage a local labor agency to maintain these files.

4.3 Basics of Compensation

Base Pay

Base pay is paid monthly and varies from 12-14 months. A 13-month pay scheme is common in China, with the additional month's pay issued during the Spring Festival month (usually February). The minimum wage in Shanghai and Beijing is 1280 RMB/month and 1160 RMB/month respectively. However, salaries for mid-level positions and experienced professionals are growing fast and may come close to rates in developed countries such as Germany or the US for a few positions. Due to the serious shortage of managerial talent, such competitive salaries are required to attract and retain good employees.

Incentive Pay

Incentives can be paid monthly, quarterly or annually and are increasingly tied to individual performance. While not required, most employers pay annual bonuses ("13th month pay") at the Spring Festival. The concept of performance-based variable pay is now welcomed by many organizations and Chinese employees. Especially within China's first tier cities, success and monetary reward through performance differentiation are concepts that employees usually appreciate.

Some of the incentives in use include: individual performance plans, team performance plans, cash profit sharing plans (payouts based on organizational profitability), comprehensive performance plans (awards based on the performance of the company, team and individuals), sales bonus plans, sales commissions as well as special recognition awards.

Allowances

Personal allowances are a somewhat unique and very important form of compensation in China. Although FIEs are not obliged to provide it, allowances are sometimes viewed to be more valuable than the cash equivalent in the Chinese culture. Cash allowances highly valued by employees include transportation, meals, clothing and child care allowances.

Benefits

Benefits for Chinese employees can be classified as mandatory or supplemental. Mandatory benefits contributions by both employers and employees are stipulated by the China Labor Law and comprise a significant portion of the total compensation. An example of the social benefit schemes widely adopted for Shanghai and Beijing residents is detailed below.

*Social Benefits	Beijing		Shanghai	
	By Employer	By Employee	By Employer	By Employee
Pension insurance	20%	8%	22%	8%
Unemployment insurance	1%	0.2%	1.7%	1%
Medical insurance	10%	2% + 3	12%	2%
Workplace insurance	0.5%	-	0.5%	-
Maternity insurance	0.8%	-	0.8%	-
Public housing fund	12%	12%	7%	7%
Total	44.3%	22.2% + 3	44%	18%
Maximum cap	RMB 12,603		RMB 11,688	
Minimum base	RMB 1,680	**RMB 2,521	RMB 2,338	

** Applies to foreign workers holding valid work permits, excluding Housing Fund*
***Applies to Workplace & Maternity insurance*

Increasingly common, supplemental benefits are voluntarily provided by the employer, especially for employees over certain pay levels.

The net salary of a Chinese employee will thus be computed as such:

Net Salary = Gross Salary – Social Benefits (By Employee) – Deductable – IIT
IIT: Individual Income Tax (refer to Page 22 for more information on computation method)

A detailed sample calculation of employee's social benefits, income tax and net salary can be found in Appendix.

4.4 Terminating the Employment Relationship and Severance Payment

China's Labor Law requires companies to pay severance unless the employer dismisses its staff with a specifically defined cause, such as that the employee failed to satisfy the conditions of the recruitment under the probationary period, seriously violated company regulations or committed a civil crime. In other situations, the employer will be required to give 30 days' notice to the employee and/or pay compensations stipulated by the provincial governments. Severance pay is generally equivalent to one month's salary per year of service. The labor law also requires companies to consult with the appropriate labor union if they wish to reduce their workforce.

Severance payments are usually required unless the employee is dismissed with a specifically defined cause or if the contract is terminated by employee himself or herself without complications. However, Severance payments will not be required if the employee does not agree to renew the contract despite being offered the renewal with the same or better conditions than those stipulated in the current contract.

A specifically defined cause includes the following acts by the employee:

The employee:
- Proven not to be able to satisfy the conditions for employment during the probation period
- Materially breached the employer's specified rules and regulations
- Caused substantial damage to the employer through serious negligence of duty or graft
- Is unable to complete conflicting tasks given by two different employers

If severance payments are required, they are generally equivalent to a month's worth of salary per year of employment in the company. For employment periods of less than six months, half of a month's salary shall then be paid as severance payment.

Nonetheless, companies should note that this is only applicable if the employee has been given at least 30 days of prior written notice, or one month's wage in lieu of notice.

4.5 Turning to HR Outsourcing Services

HR business processes are often resource-intensive and time-consuming. As a result, more and more companies are now choosing outsourcing as a cost-effective solution. Generally HR outsourcing services can be separated into two categories: **HR Agency Services** and **Talent Dispatching Services**.

HR Agency Services encompass basic HR administration, such as: Employment & Dismissal, Payroll & Individual Income Tax Administration, Social Security & Housing Fund Setup & Administration as well as Personnel File Management.

Talent Dispatching Services are used by companies and representative offices to engage an authorized third-party HR representative to employ, sign labor contract and dispatch staff to their offices. The HR representative will also provide all HR Agency Services mentioned above. Particularly for Representative Offices in China, Talent Dispatching is the only avenue to legally recruit local employees.

The details of typical services provided by HR Service Providers include:

- **Labor Contract (only applicable to Talent Dispatching Services)**
  Sign labor contracts with its client's employees, taking legal liability as the official employer.

- **Employment & Dismissal**
  Chinese law requires all labor contracts to be registered with the relevant authorities.
  The authorities would also have to be informed of any dismissal of employees.

- **Payroll and Individual Income Tax Administration**
  Issuance of salary to employees, as well as withholding and submitting taxes to the relevant government authorities on behalf of its client.

- **Social Benefits and Insurance**
  Administration of all social Benefit and Insurance payments on behalf for the client's employees
  Some providers may also be able to offer wide variety of insurance schemes, including group insurance provisions for additional coverage.

- **Personnel File Management**
  Collects and maintains the personnel file and all related certifications during the employee's employment period. Each employee in China owns a personnel file, which contains his or her resume, birth certificate, university degree, etc.

- **Recruitment & Staffing**
  Analysis of the job description, search planning and identification of best fit candidate for the client's needs. Staffing solutions are also highly sought after services by companies in China.

A good HR service provider should also provide consultation on labor and HR related policy for the client, as well as assist in negotiating and managing labor disputes and emergencies during the employment term.

4.6 Things to Note for HR Managers

1. **Do set up company policies to regulate employees' daily working behavior.**

   An employee can only be dismissed without paying severance payment if he or she has been found to have seriously breached a company policy that has been acknowledged and signed by the employee. Hence, it is very important for employers to specify clauses to define acts that are harmful to the company in any way.

2. **Do sign a binding contract with an employee if paid training is provided.**

   An employee can be required to serve a certain period of time with the company if he or she has been provided with training paid by the company. The company is then entitled to demand payment for the training costs if the employee leaves the company prior to the contract expiration date.

3. **Do set probation periods according to the regulations.**

   The labor contract law requires probation periods to be not more than a month if the contract term is three months or more but less than a year, and not more than two months if the contract term is less than three years. If an employment contract has a term of at least three years or is open-ended, the probation period should not exceed six months.

4. **Do not deduct salaries of employees for any reason other than those allowed by the labor law.**

   Employers are not allowed to deduct an employee's salary even if company policy has been breached. This is unless an agreement has been reached in writing by both parties.

5. **Do not detain employees' ID card or charge any deposit.**

   It is illegal for companies to detain employee ID cards or require deposits to regulate their behavior. Instead, detailed company policies should be drafted as explained earlier.

6. **Do not change job positions of employees without their consent.**

   The employee is protected by the law from unilateral amendments to his or her job position by the company. Any amendments should be agreed upon and signed in an agreement by both parties.

7. **Do not terminate employment with the employees during their medical or maternity leave.**

Companies are not allowed to terminate employment contracts with their employees during their medical or maternity leave other than those allowed by the labor law. However, they are allowed to make changes in the labor contract if the changes have been agreed by both parties in writing.

4.7 Consequences of Breaching the Labor Contract Law

Companies are reminded not to breach the labor contract law or take advantage of their employees for short-term gains. While the employee may not retaliate during the period of employment for fear of losing their job, employers are actually liable for damages anytime until a year after the employee has left the company.

Foreign companies should also note that the labor rights of employees are well-publicized and understood in China. Hence, HR departments are advised to be well-versed with the new labor contract law and not breach any clauses intentionally or accidentally.

The labor contract law of China does not apply to foreign workers working in a foreign company in China. However, foreigners working in domestic companies are subjected to the labor contract law of China.

4.8 Key Components of a Sound Retention Plan

A sound talent retention plan is the key to sustaining one's success in China. Without talent retention, continued implementation of strategies will be difficult and additional expenditures such as recruitment and training costs will be incurred.

1. **Remuneration**

Salaries often reflect one's social status in China. Hence, better opportunities are often synonymous with higher salaries. This is a root cause behind the worker retention problem in China. In fact, many talented managers have been poached by competitors on the basis of higher salaries. Thus, it is extremely important to keep salaries competitive with market levels, especially for senior positions.

2. **Training and career development**

While competitive salaries offer a short-term solution to retaining talent, training and career development allow companies to align their long-term strategies to employees' career goals. As foreign languages and specific skill sets are very relevant to one's career progression, professional training in these areas tends to be highly sought after. Others include clearly specified promotion criteria as well as regular departmental rotation programs. However, employers should note that mentorship programs are now considered to be less desirable, as mentors often withhold important skills and knowledge from their apprentices in order to secure their own positions in the company.

3. Organizational culture

In general, Chinese employees prefer flexible organizations that place greater emphasis on interpersonal relationships. This allows room for creativity and creates a friendly working environment on the basis of helping each other instead of following orders. Thus, it will be beneficial for foreign companies to adapt their cultures and inculcate a greater sense of ‘family’ in their China offices. This will create a sense of belonging to the company and instill greater teamwork among the employees.

4. Quality of relationship with employees

Just as relationships are important in managing external parties in China, relationships are also necessary in managing and retaining employees. It is a common mistake for managers to distant themselves away from their subordinates. They should instead build genuine friendships with their subordinates such that the latter will remain loyal to the company even in times of difficulties or despite receiving better offers. However, managers should also note that such relationships work in both ways - they may eventually find it difficult to terminate non-performing employees as a result of the personal relationships that may be involved.

5 Individual Income Tax in China

Factors such as the type of legal entity the employee is working for along with the position the employee holds influences tax liability. This guide gives a short overview on the Chinese individual income tax regime with a focus on the taxation of the income of foreign employees and how it is applied in Shanghai and Beijing at the time of writing. Note that there is no uniformity throughout the country on how individual income tax is applied; there are significant differences even between cities such as Beijing, Shanghai, and Guangzhou. In general, China adopts a tax withholding system, whereby the employer deducts relevant payment from the employees' monthly salary and pays the local tax bureaus on behalf of the employees.

5.1 Local Employees

Individual Income Tax

Local employees are taxed on the basis of the balance of their monthly income after deducting their social benefits contribution, a standard deduction of RMB 3,500, and then applying the progressive tax rate as shown in the table on below. The employer is obliged to withhold the full tax amount and submit the taxes to the appropriate Chinese authorities on behalf of its employees.

Taxable Income = Gross Salary – Social Benefits – ¥3,500
IIT = Taxable Income x Tax Rate – Quick Deduction
Net Salary = Gross Salary – Social Benefits – IIT

A detailed sample calculation of employee's social benefits, income tax and net salary can be found in Appendix A.

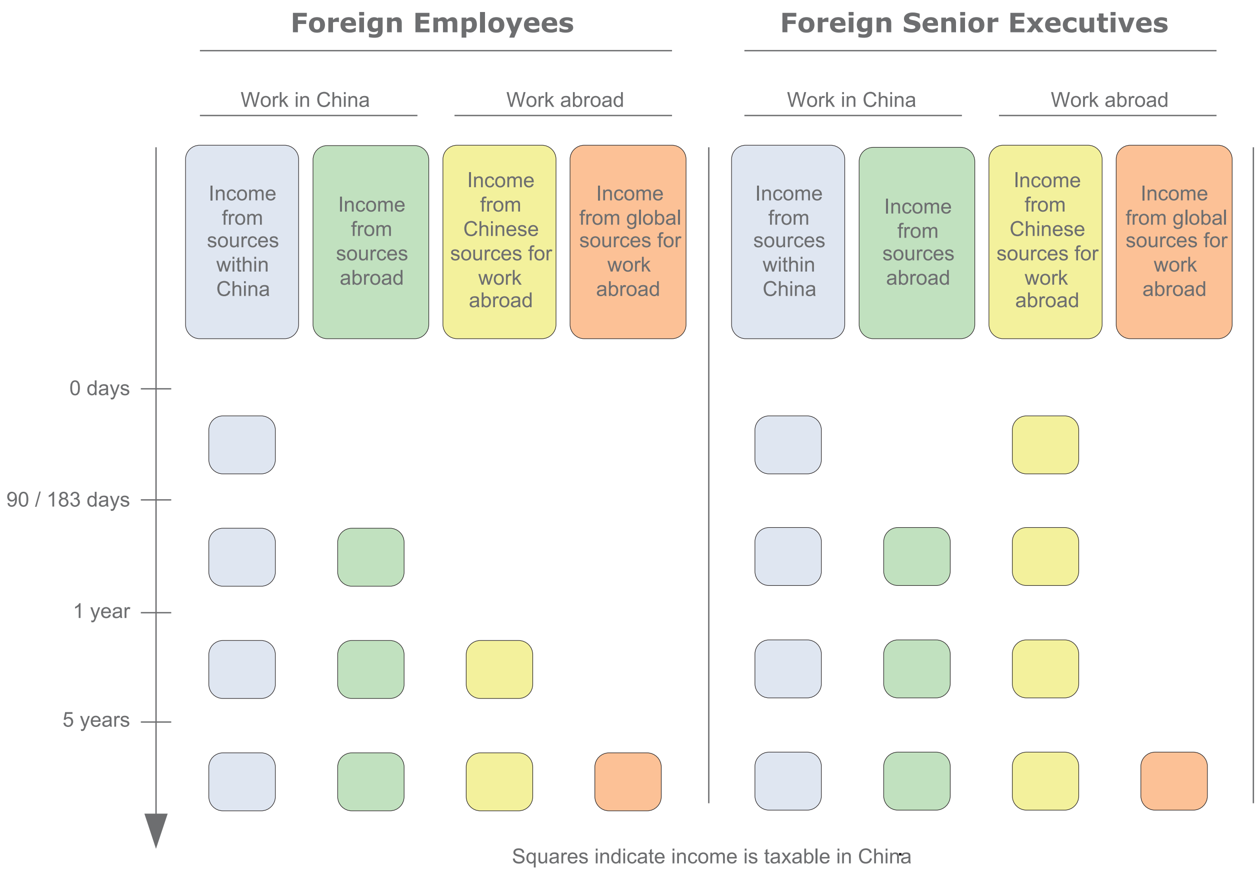
Taxable Income	Tax Rate	Quick Deduction
Less than 1,500	3%	0
1,501 – 4,500	10%	105
4,501 – 9,000	20%	555
9,001 – 35,000	25%	1,005
35,001 – 55,000	30%	2,755
55,001 – 80,000	35%	5,505
Over 80,000	45%	13,505

5.2 Foreign Employees

The incomes of foreign employees in China are taxed by the same progressive tax rates as incomes of Chinese employees. However the important question is, when foreign nationals' incomes are subject to Chinese individual income tax liabilities.

Tax Liability

The criterion used to determine a foreign employee tax liability in China is the duration of stay. Another distinction has to be made between junior staff and senior executives. Foreigners and Chinese from Hong Kong, Macao and Taiwan have to pay IIT on incomes derived from Chinese sources for work in China if they have lived in the country for less than 90 days (183 days for citizens of countries that have signed a treaty on the avoidance of double taxation with China[6]). If a foreign employee has been living in China for more than 90 days (183 days) but less than a year, income for work in China from all sources is taxable. Foreign senior executives (e.g. CEOs, General Managers, Chief Representatives, etc.) however, are liable for their full income derived from Chinese sources from the first day in the country. For better understanding taxable income for longer periods of stay and for senior officials compared to ordinary employees, please see the chart below.



Squares indicate income is taxable in China

6. *These include among others: the EU-25 (except Greece), Australia, Brazil, Canada, Hong Kong, India, Indonesia, Japan, Macao, Malaysia, New Zealand, Norway, Russia, Singapore, South Africa, South Korea, Switzerland, Thailand, USA, Vietnam*

However, one special situation needs to be mentioned: The salary of a Chief Representative (of a representative office), which is issued by the parent company abroad, is taxed on a prorated basis even for durations of stay of less than 90/183 days per year. The Chief Representative must apply for part-time status, which allows him to pay taxes on his income from abroad only for the time spent in China. This rule does not apply for senior officials of WOFE's, because these are registered as Chinese companies and pay their employees from within China.

Registration Procedures
If the employee is liable for China tax filing, the following procedures for registration apply and the following documents are required:

- Original salary certificate from overseas employer
- Copy of employment contract
- Copy of all pages of passport
- If the employer is a "permanent establishment" in China then: employee's work permit, employer's tax registration certificate and employer's business license

Tax Calculation
After knowing which incomes are subject to Chinese IIT, the calculation process is only slightly different from the one described for Chinese nationals. The same tax rates and tax brackets also apply for the incomes for expatriates working in China or for Chinese companies. Foreign employees may, however, deduct an amount of RMB 4,800 before calculating the tax payable according to the formula on page 22. Moreover, foreigners in Shanghai may pay social insurance as local Shanghainese do, however it is not mandatory and an employer and employee should come to agreement on the subject. Some allowances and benefits paid by the employer are not taxable.[7]

Example:

Gross Salary (RMB)	Taxable Income (-4,800)	Tax Level	Tax Rate	Quick Deduction	Tax Payable	Net Salary (RMB)
8,500	3,700	2	10%	105	265	8,235

5.3 Annual Income Tax Filing

IIT self-declaration in China is intended to cultivate the individual taxpayers' consciousness of their tax responsibilities. China's tax regulations require taxpayers who fall under any of the following five categories to self-declare their annual income:

(1) With annual income of RMB 120,000 or more
(2) Receiving salary and remuneration from two or more employers in China
(3) Generating income abroad
(4) Generating taxable income without withholding agent
(5) Other cases as specified by the State Council

7. This includes allowances for home leave (only applicable twice a year), language training, children's education, housing rental, moving, food, washing of clothes and business trip expenses.

For Scenario (1), tax payers are to declare taxes to relevant authorities within three months after the end of a tax year (i.e. between Jan 1st to March 31st each year). For Scenarios (2) to (4), they shall perform tax declaration upon receipt of the income.

5.4 Annual Income Tax Filing Procedures

Several possible modes of tax declaration include online, mail or direct to the local tax authorities. Tax payers may also entrust intermediary agencies or other persons qualified for tax agency service with their tax declarations.

When computing the annual income, the individual must take into consideration the following 11 components:

1. salary and compensation
2. income from production and operation by individually-owned business
3. income from contact operation and operation under lease of enterprises or social service providers partly or wholly funded by state assets
4. compensation for labor services
5. author’s remuneration
6. royalty
7. interest, dividend and bonus
8. income from lease of property
9. income from transfer of property
10. incidental income
11. other income specified by finance department under the State Council

As shown in the examples in the earlier sections, tax payers are allowed deductions from their taxable income, such as social insurance contributions and a general deduction amount of RMB 2,000 for locals and RMB 4,800 for foreigners. Furthermore, the regulations also allow certain tax exemptions, such as particular rewards in respect to science, education, technology, and culture; interest of treasury and financial bonds issued by China; specific academic subsidies or allowances; welfare and relief for the disabled.

5.5 Liabilities for Non-Payment of Tax

If an individual fails to declare his or her taxes within the specified three-month period, the local authorities may provide an extended deadline but may also impose a penalty for late payment. If the taxpayer fails to make a tax declaration again, or fails to pay or underpays the tax payable, the taxpayer will be held liable for the amount of tax payable along with a possible surcharge.

5.6 Repatriation of Salary Paid in RMB in China

Foreign employees may repatriate their total monthly net salary back to their home country. In order to convert their RMB salary into foreign currency, they will need to present to their local bank proof of tax payment, their Alien Employment Permit, proof of income as well as other documents required by the bank.

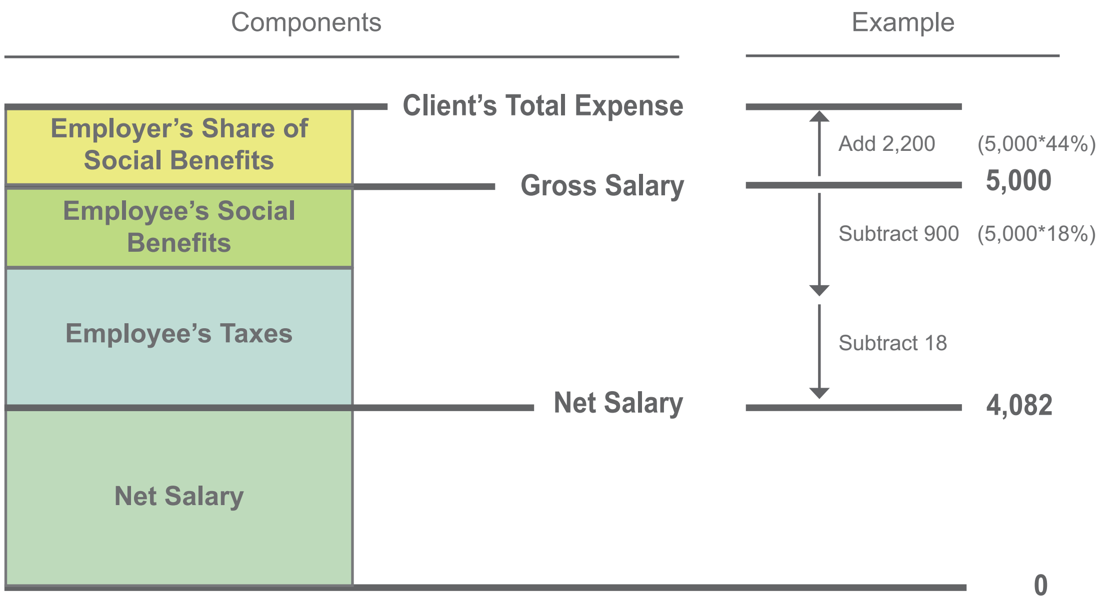
Appendix: Sample Calculation of Social Benefits, Income Tax and Net Salary In Shanghai

The following illustrates the sample calculation of social benefits, income tax and net salary for an employee earning a gross salary of RMB 5,000. In this example, one clearly notices that the total amount payable by the employer can be significantly higher than the gross salary (44% above the agreed upon salary).

Gross Salary	Company Expenses								
	Social Benefits						Housing Fund[1]	Total	Total Expense
	Pension	Medical Insurance	Unemployment Insurance	Maternity Insurance	Workplace Insurance	Sub-Total[2]			
	22.0%	12.0%	1.7%	0.8%	0.5%	37.0%	7.0%	44.0%	
	1,100	600	85	40	25	1,850	350	2,200	7,200

Gross Salary	Employee Expenses							
	Social Benefits				Housing Fund[3]	Income Before Tax	Individual Income Tax[1,4]	Net Salary
	Pension	Medical Insurance	Unemployment Insurance	Sub-Total[5]				
5,000	8.0%	2.0%	1.0%	11.0%	7.0%			
	400	100	50	550	350	4,100	18	4,082

Employer's and Employee's Share of Social Benefits and IIT



1. *Maximum Housing Found payment borne by company is 11,688 * 7% = ¥818 and Minimum is 1,120 * 7% = ¥78*
2. *Maximum Social Benefit payment borne by company is 11,688 * 37% = ¥4,324.60 and Minimum is 2,338 * 37% = ¥865.10*
3. *Maximum Housing Fund payment borne by individual is 11,688 * 7% = ¥818 and Minimum is 1,120 * 7% = ¥78*
4. *Includes Standard RMB 3,500 deduction and Quick Deduction*
5. *Maximum Social Benefits payment borne by individual is 11,688 * 11% = ¥1,285.70 and Minimum is 2,338 * 11% = ¥257.20*

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