Newsletter

HENDERSEN CONSULTING
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Comparison of Trading Vehicles in China

Background

Trading, especially domestic trading, has been a restricted sector for foreign investment in China for years. When China joined the WTO in 2001, it made a commitment that the restrictions on trading rights for most products will be phased out by end of 2004. At that time, many people worried about whether China will live up to its promise. Now the question becomes how this commitment is realized.

A first break-through for foreign investors in the trading sector is the signature of the Closer Economic Partnership Arrangement ("CEPA") between Mainland China and Hong Kong Special Administrative Region, which gave qualified Hong Kong registered companies a privilege to set-up a wholly owned commercial enterprise even before the sector is opened under China's WTO commitment. Next, the Ministry of Commerce ("MOFCOM") issued the "Management Measures on Foreign Investment in the Commercial Sector" (MOFCOM Decree 8 [2004]), which provides a level playing field to foreign investors from any countries/regions. Soon after that, the MOFCOM issued two circulars Circular 9 [2005] and Circular 76 [2005] on April 2 2005 and July 13, 2005 respectively. The two new rulings further allows existing foreign-invested noncommercial enterprises ("FINE") and the international trading companies located in free trade zones ("FTZ Tradeco") to upgrade their business scope to cover domestic trading and distribution activities.

Alternatives for Trading Vehicles

A foreign investor can now set-up a trading vehicle in China, depending on its specific circumstance, in the following forms:

1) Commercial Enterprise under Decree No. 8.,
2) A traditional FTZ Tradeco (with international trading license),
3) FTZ Tradeco with expanded business scope (with international + domestic trading license),
4) A FINE with an expanded scope to trade non-self made products, or
5) A regional headquarter (RHQ) upgraded from a Chinese Holding Company (CHC).

A comparison of the above vehicles is set-out below:

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		Commercial Enterprise	**FINE (Expanded Business Scope)**	**FTZ Tradeco (Traditional)**	**FTZ Tradeco (Expanded Business Scope)**	**RHQ**
Business Scope	Import	Y	Y	Y	Y	Y (Limited to products of same group)
	Export	Y	Y	Y	Y	Y
	Entrepot Trade	Y (But may have duty disadvantage)	Y (But may have duty disadvantage)	Y	Y	Y (But may have duty disadvantage)
	Domestic Trading (Wholesale)	Y	Y	N	Y	Y
	Domestic Trading (Retail)	Y	Y	N	Y	Y
	Issue VAT Invoice	Y	Y	Through Bonded Market	Y	Y
	Ability to Set-up Branches	Y	Y	N (Liaison office only)	N (Liaison office only)	Y
Set-up Requirement	Minimum Registered Capital	USD 140,000	N/A	USD 140,000	USD 140,000	USD 50 -100 million
	Set-up Timing	6 months	3-6 months for upgrade	1-2 months	3-6 months for upgrade	3-6 months for upgrade
Financial/Tax Incentives	Enterprise Income Tax Rate	33% (may reduce to 15% in certain locations)	Follow FINE's treatment if trading revenue < 30% of total	15% if registered in Shanghai FTZ	15% if registered in Shanghai FTZ	33% (may reduce to 15% in certain locations)
	Financial Subsidies (VAT, BT, EIT)			May obtain a refund in the form of financial subsidy	May obtain a refund in the form of financial subsidy	

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How Do You Make Your Choices?

Some clients told us recently that when they ask about the most appropriate trading vehicle for them in China, different people will provide different answers. It is true in a sense that there are more choices today, it becomes a more difficult decision making process. While the exact situation may vary from case to case, there are some tips:

- A thorough analysis of the business objective is vital. For instance, for companies whose business objective is to do importation and sourcing from China, FTZ Tradeco would still be a flexible vehicle with less set-up cost and timing.
- To clearly know your current set-up in China would help. It is always easier to utilize an existing legal entity than to set-up a new one, if they can fulfill the same business objectives. Besides, there would be a lot of administrative efficiencies and cost savings in maintaining less legal entities.
- A financial and tax analysis would be necessary. Since the financial and tax implications for the different vehicles may vary a lot, an appropriate trading vehicle may derive significant savings. Especially in the case of FINE, since to incorporating trading activities may change the existing tax incentive scheme, a cost-benefit analysis would be critical.

What Can Hendersen Help?

Hendersen can offer a range of services in forming your trading vehicles in China:

Planning Stage

- Business objectives drill down
- Functional analysis of the trading vehicle
- Financial/tax cost-benefit analysis

Implementation Stage

- Establishment of the trade vehicle
- Establishment of the outlets for the trade vehicle
- Negotiation of financial/tax incentives
- Establishment of the customs/logistics/accounting systems
- Work-out the transfer pricing policy

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