INTEGRA
GROUP

The China Market Entry Handbook

A guide for foreign invested enterprises doing business in China

2021 EDITION

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.

FOREWORDS

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. Nowadays, foreign companies in China enjoy a more mature market than ever before, with a tax and regulatory environment that converges significantly with western and international practices.

In our experience, it is often the Chinese characteristics of tax administration and compliance procedures that present some of the biggest challenges for foreign invested enterprises in China. It's best to ensure compliance from the outset in order to mitigate the risks of non-compliance and maximize the efficiency of internal procedures. This publication is intended to help foreign investors understand the various accounting, tax, and HR compliance issues they will face in China.

Many of the tax and regulatory compliance practices that foreign invested enterprises are encouraged to follow 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.

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Follow us on WeChat to stay up to date on accounting, tax, and HR issues in China. We share current policy updates and practical resources to guide foreign businesses in China.

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HOW TO PROPERLY REGISTER A COMPANY IN CHINA

Registering a Foreign Invested Enterprise (FIE) is the first step in your journey of doing business in China. During the set-up 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 oversea 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 Industry and Commerce (SAIC). 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 (2019)*
>
> *FI Negative List - Special Administrative Measures on Access to Foreign I nvestment (2019)*
>
> *MA Negative List - The Negative List for Market Access (2019 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

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> *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.*

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 Minumum Registered capital to Total Investment	Note
3 million or below	70%	
3 million – 10 million	50%	Not less than US $2.1M
10 million – 30 million	40%	Not less than US $5M
30 million or above	1/3	Not less than US $12M

Other Issues

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

Company (Chinese) Name – needs 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, 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.

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.

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.

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	城镇土地使用税
	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

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%

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 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 oversea entities, and only perform liaison & promotional activities in China for their oversea 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 oversea 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 1st, 2020, China has DTAA's in place with 110 jurisdictions. It's important to consider the implications of a DTAA before deciding on a final investment structure for your new company.

TAX FILING REQUIREMENTS

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.

	Tax Filing Period	Due Dates
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	1st 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	1st March - 30 June of the following year
Custom Duty	On a transaction-by transaction basis	

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.

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 below chart 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	• Quarterly filing	• Monthly filing; • Transactional filing
CIT Filing	• Quarterly filing; • Annual CIT reconciliation filing	• Quarterly filing; • Annual CIT reconciliation filing
Annual Audit	• Not mandatory for compliance purposes	• Not mandatory for compliance purposes
Joint-Inspection	Required for compliance purposes	Required for compliance purposes

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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 make important decisions.

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, the company applies for a tax refund, or revenues exceed 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 it's 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 concecutive months.

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.

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:	20,328	136%
Gross salary:	15,000	100%
Social Security Employer	5,328	36%
Social Security Employee	2,625	17.5%
Individual Income Tax	228	1.5%
Net Salary	2,148	81%

Note: The above example is based on 2020 social security rates for Shanghai 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 by a 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.

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 **(Monthly)**		Tax Rate	Quick Deduction
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 **(Annual)**		Tax Rate	Quick Deduction
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.

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	
Childen'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*	Healthcare cost for serious illness	Over RMB 15,000 up to RMB 80,000/annum

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

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.

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.

The table below shows the tax liability for expatriates in China based on various income sources;

China IIT: Tax Resident & Non-tax Resident						
			China sourced income		Oversea sourced income	
	Stay in China		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

HOLIDAYS AND LEAVE

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.

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, and 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;

- Termination of a labor contract is mutually agreed upon; or,
- 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.

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 + 30 days	Pay is covered by the local Social Security Bureau up to certain limits; Women over the age of 24 are given additional time for "late childbirth".
Paternity Leave	0 - 15 days	Regulations regarding paternity leave vary between local jurisdictions, as does the method of calculating compensation.

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 MSMEs 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%).
- 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

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.

ANNY WU

Senior Manager
Tax Advisory Services
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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.

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 ensured 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 are subjected to applicable CIT rates on said amount. It is important to monitor these tax-deductible thresholds and be mindful of the additional tax payable above these limits.

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 Limit: Annual Gross Revenue	60% 0.5%	Non-transferable 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

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.

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.

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

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.

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.

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 Association 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.

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.

Dividend Payments

	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.

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Service Agreements

	Calculation	Amount
Service Agreements	(a)	100
VAT	(b) = (a) / (1+6%) x 6%	5.66
Local Surcharges*	(c) = (b) * 12%	0.68
Withholding CIT**	(d) = (a) / (1 + 6%) x 30%*** x 25%	7.08
Net amount for repatriation	-	86.58

*Local Surcharges vary between cities and by district.
** Withholding CIT paid in China can be deducted from the tax liability overseas under a DTAA.
*** Based on a deemed profit rate of 30%.

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Royalties

	Calculation	Amount
Royalty	(a)	100
VAT	(b) = (a) / (1+6%) x 6%	5.66
Local Surcharges*	(c) = (b) * 12%	0.68
Withholding CIT**	(d) = (a) / (1 + 6%) x 10%***	9.43
Net amount for repatriation	-	84.23

*Local Surcharges vary between cities and by district.
** Withholding CIT paid in China can be deducted from the tax liability overseas under a DTAA.
** The CIT rate is based on the standard 25% CIT rate for a deemed profit of 40%.

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Foreign Loan Interest Payments

	Calculation	Amount
Interest	(a)	100
VAT	(b) = (a) / (1 + 6%) x 6%	6
Local Surcharges*	(c) = (b) x 12%	0.68
Withholding CIT**	(d) = (a) / (1 + 6%) x 10%***	9.43
Net amount for repatriation	-	84.23

*Local Surcharges vary between cities and by district.
** Withholding CIT paid in China can be deducted from the tax liability overseas under a DTAA.
** The CIT rate is based on the standard 25% CIT rate for a deemed profit of 40%.

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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.

TRANSFER PRICING IN CHINA

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 and 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.

In addition, should qualified non-resident foreign enterprises decide to invest in industries outlined in the "*Catalogue of Encouraged Industries for Foreign Investment*", PRC tax law provides a special deferral of withholding CIT derived from resident companies in China. To take advantage of the full range of profit repatriation methods available and achieve an optimal tax liability, foreign investors are encouraged to plan ahead.

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."

MARKETING IN CHINA'S NON-HOMOGENOUS MARKET

When first entering the China market, many companies localize and adjust their content, creative designs and slogans specifically for Chinese customers. However, foreign businesses should understand that China's population of 1.4 billion is not a homogenous market, and demographics change from city to city, alongside average income and consumer habits. Therefore, brands that conduct marketing in China should consider their target audience and realize that the 'one size fits all' model often does not work. Instead, different campaigns should be developed for different customers.

CHINESE CITY TIER SYSTEM

One method of characterizing Chinese customers for marketing purposes is through the cities they live in. Cities in mainland China are often classified under an unofficial Chinese city tier system. Although the city tier classifications are not published or recognized by the Chinese government, due to the rapid economic developments in China, the system has gained widespread popularity and use in industries such as marketing, commerce and transportation. Oftentimes, the city classifications are used to distinguish differences in income levels, demographics and consumer behavior, preferences and trends.

Since the city tier system is not official, there is not one single version. As such, the city classifications may vary depending on who is doing the classifying or on future developments. That being said, generally speaking, four to six tiers are used for city classifications, with the higher tiered cities (tier 1 and 2) representing the more developed regions of the country that have a higher GDP and a more affluent population. The highest tiered cities usually include Beijing, Shanghai, Guangzhou, Shenzhen, Tianjin and Chongqing.

MARKETING THROUGH THE CITY TIER SYSTEM

The city tiers are frequently used to develop marketing strategies in China. Cities in tier 1 have maturing markets in many more categories and have the infrastructure and logistics networks required to support more complicated business operations and sales channels. Additionally, customers from tier 1 cities have, on average, a higher income and more sophisticated consumption preferences. Consequently, brands hoping to market in higher tiered cities need to take this information into account and develop campaigns that are most likely to interest an audience in these cities. When developing the campaign, brands should also consider the message that they're trying to convey and adjust it according to the city characteristics, e.g. whether to include messages that appeal to tradition or to include more trendy and modern topics.

On the other hand, higher tiered cities have begun to reach saturation in some categories and have much greater competition among businesses. As such, brands have also begun to turn their attention to lower tiered cities, many of which are developing both economically and in terms of consumer income, spending, and sophistication. These lower tiered cities are opportunities for businesses to reach potential new customers from a market that is smaller, but also has less competition and is likely to continue growing rapidly. In fact, consumers from lower tiered cities tend to be optimistic spenders and have shown an increasing interest in premium goods. Due to the rising use of the internet in lower tiered cities, the consumption potential of these markets is especially evident online and in e-commerce. Brands that are unable to open up physical stores in these smaller cities are still able to reach customers through online shopping.

Although city tier classifications can be a useful tool when devising marketing strategies, it is important to take other factors into account as well. Doing so ensures that companies do not miss out on opportunities and do not discount cities simply because of their tier level. Moreover, cities within the same tier level may not have exactly the same characteristics. Taste preferences are one example of a difference than can occur between cities of the same tier level because it is more dependent on cuisine and where the city is located in China. Another example is personal care or skincare routines, which can be highly dependent on the city climate and pollution levels.

PERSONALIZATION IN CHINA

One trend that has been gaining popularity in China is personalization and appealing to the individual customer. With more information shared online than ever before, brands and companies also have access to more personal data on their customers. This is especially true for businesses that have social media accounts, which they can leverage to gather insights and detailed demographic data on their followers through follower activity.

Using the additional information collected, businesses can then segment their customers according to demographic data, e.g. income level, buying habits, consumer behavior, interests, family status, age, etc. After segmentation, brands and companies can individually target consumers that have a certain characteristic by offering content, services, products or promotions that are specifically designed for that customer trait. Using this method will likely result in a higher conversion rate for businesses, as they are appealing directly to their customers' interests, and can also help with building customer loyalty.

As China is one of the largest markets in the world, many businesses and brands seek to establish themselves early on. The tier system has rightfully earned its place as a common referencing system and has helped businesses understand China's many cities early on. For companies that achieve long-term success in China, their goal should be to continuously build more detailed customer segments and market specifically to their unique segments as it relates to their product or service. Doing so will allow the business to devise a more appropriate marketing strategy and will also ensure that brands create a lasting image in the minds of their customers.

RedFern Digital is a China specific full-service agency that helps brands navigate the digital and ecommerce ecosystems, increase their brand awareness and convert that awareness into sales. After 15 yeras in China, we have grown alongside our clients, some of which are now among the most successful brands in-market.

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"The tier system has rightfully earned its place as a common referencing system and has helped businesses understand China's many cities early on."

ABBREVIATIONS

BRI – Belt and Road Initiative

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.

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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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Corperate Tax	**Payroll & HR**	**Due Dilligence**	**CFO Services**

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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.

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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