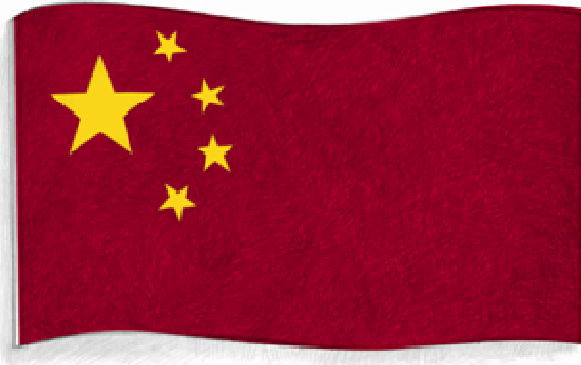


What to consider when **structuring investments into China**

The continuing increase in foreign direct investment in China has led to significant improvements in the country's legal and regulatory framework. However, there are still some key considerations for those wanting to invest in the world's leading recipient of foreign capital. To successfully invest in China due diligence on the proposed investments, structuring the operation effectively at the outset and close monitoring of the business are important.



Investment categorisation

In China, the State still plays a key role in the regulation of foreign investment. An investment into China is categorised as 'encouraged', 'permitted', 'restricted' or 'prohibited' depending on the nature of the investment and/or the sector in which an investment is being made. This categorisation may affect the way an investment is structured, whether there are any limits on foreign participation and also determines the level of governmental approval required.

Choice of entity

The most common choices of entity include setting up a representative office (which cannot engage in direct business activities) or a foreign investment enterprise (FIE) - typically either a wholly foreign owned enterprise (WFOE) or a joint venture with a local Chinese partner. In any case, governmental approval is required when setting up any form of entity.

Selecting a location

With many special zones and various incentives on offer, determining where to set up can be a difficult choice. Whilst China's coastal provinces are more developed and offer better infrastructure, labour and land are less costly in central and western China. Development zones and free trade zones offer special tax incentives and specific benefits which may be of relevance depending on the type of activity and investment being made.

Use of an intermediary holding company

Using an intermediary holding company structure can help in managing tax leakage on the extraction of profits out of China by, for example, minimising the level of withholding taxes on dividends, interest and royalties. The flexibility afforded by an intermediary holding structure can also help to limit the applicability of certain regulatory requirements in China as well as provide an alternative exit strategy from the China investment should this be sought. Hong Kong and Singapore intermediary holding structures are regularly used and offer significant commercial and tax benefits.

Staffing

A strategy for attracting and retaining a skilled workforce is essential as China's labour market is highly mobile. Companies should not underestimate the level of senior management time required to set up a successful operation. Clear strategies for retaining staff are necessary and there are good tax incentives for expatriates.

Financing operations

Making the correct choice on how to fund a Chinese business is crucial. Companies must balance use of equity and debt. Careful modelling of likely finance requirements is recommended as obtaining approval for additional funding is a time-consuming process and equally extracting surplus cash can be difficult. Whilst many companies prefer to debt-finance Chinese entities when possible, minimum capital and other investment criteria must be met and levels of interest deemed 'excessive' will not be tax deductible. A careful review of the supply chain is also recommended to ensure profit can be extracted in a tax efficient manner on a timely basis.

Tax incentives

Various tax breaks and reduced rates are available to FIE's depending on the industry and location. Incentives are often available for investments considered to be 'hi-tech' or for R&D related activity.

Protection of intellectual property rights

Whilst there have been huge improvements recently, enforcement of intellectual property rights continues to be a perceived issue in China. It is advisable that such rights are properly registered when considering investment into China and that additional measures such as contractual protections, workplace security and anti-counterfeiting measures are taken to protect any intellectual property. Careful management of the supply chain can assist in protecting IP. Technology licenses into China will typically require registration, and, in the case of restricted technology, advance governmental approval.

Who should I contact?

Whether you are looking to grow your business by exporting, investing or doing business in China, Grant Thornton's dedicated China Britain Services Group has the international capability, the cultural understanding and the partner commitment to help you drive your business forward.

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