



U.S. Tax Exempt Organizations Doing Business in China: Three Components for Entering the Chinese Market

By: Richard Bar

You are the CEO of a national, or perhaps international, tax exempt organization interested in expanding your operations in the People's Republic of China. While it is true that business activity between United States and PRC companies continues to increase, language and cultural differences, as well as decades of mistrust between the U.S. and the PRC, remain obstacles that must be handled with delicacy and patience. This article discusses three key components for U.S. tax exempt organizations desiring to enter the PRC market.

Qualified PRC Based Consultant. In order to open an office in the PRC, your organization must obtain approvals and permits from the PRC. A tax exempt organization in the U.S. has many business advantages. Of course, the tax exempt designation carries with it economic benefits, both with respect to limiting tax payment obligations as well as promoting the "good" work that is the heart of the organization's mission and purpose. In the U.S., "good work" is essential and viewed as a significant positive factor. However, surprisingly, the PRC is very suspicious of U.S. tax exempt organizations and their purposes. PRC agencies involved with the review of your request to do business in the PRC often look at U.S. tax exempt organizations as U.S. government approved entities and, therefore, as extensions of the U.S. government. Centuries of mistrust, cultural differences and language issues create problems where seemingly none exist. Often, convincing the applicable PRC agency that your organization has little, if anything, to do with the U.S. government can be time consuming and difficult. It is essential that U.S. businesses seeking to open offices in China retain PRC based consultants who do business with U.S. entities and who are experts in the PRC permit approval process. They will smooth the review and approval process and help with cultural and language issues. These consultants also will assist with negotiating and communicating with your Chinese business counterparts. Though cultural differences and language nuances always will be present, you can minimize misunderstandings and potential disaster with trusted and well qualified advisors. Our experience consistently has demonstrated that PRC based consultants with deep connections and experience with the PRC government and business community are the most effective. Their importance cannot be overstated.

Documents. Your organization will be required to submit a substantial amount of paperwork pertaining to its operations and intentions in the PRC. This will include, among other things: (i) its Articles of Incorporation, (ii) its Bylaws, (iii) a listing of all officers and directors, (iv) copies of passports of the entire Board, (v) a narrative summary of the planned business in the PRC, (vi) three years of financial statements of your organization and/or the proposed entity to be operating in the PRC, (vii) bank statements, and (viii) the office location in the PRC along with a copy of the signed PRC lease. In addition, your organization or the entity operating in the PRC will be required to post registered capital in RMB (the local currency) in an amount that will be determined during the permitting and approval process, which amount could be substantial.

Entity Structure. You will have to decide how your presence will be represented in the PRC. There are two basic types of foreign investment entity structures. First, your organization can enter into a joint venture with a PRC partner. Second, your organization can establish a wholly owned foreign entity (known as a WOFE) which would include either a subsidiary (SWOFE) or a representative office (RWOFE). Unless a U.S. tax exempt organization has a Chinese partner in the PRC, typically joint ventures are avoided and WOFEs are created. There are important differences between SWOFEs and RWOFEs. A RWOFE is a liaison office for its foreign owner (your organization). It is subject to detailed restrictions. It cannot sell products or services and cannot sign contracts with PRC customers. It may not hire local employees. A RWOFE may not establish other representative offices in the PRC. A SWOFE may do all of these things. Moreover, the responsible person of a RWOFE must be “assigned” by the local Foreign Enterprises Services Corporation (FESCO). That person must sign an employment agreement with the FESCO. FESCO will be paid a fee by your organization. A SWOFE does not have to involve FESCO. By creating a SWOFE, your tax exempt organization would be the sole owner of the SWOFE, a separate and distinct PRC entity. Your SWOFE must report profit and loss annually in the PRC. These returns require much more accounting/auditing detail and back up information than what is required of a RWOFE. Notwithstanding the reporting requirements, most tax exempt organizations opt to create a SWOFE because (i) that entity has more ability to do more things, (ii) there is no need to interface with FESCO, and (iii) the PRC reviewing agency will analyze the records and information related to the SWOFE and not your organization and, therefore, that agency is less likely to be scared by the misnomer that your U.S. tax exempt organization is an agency of the U.S. government.

Because of these and other complexities, much analysis and thought must be given before determining the best entity structure and processes related to your organization’s entrance into the PRC. Careful and advanced planning is critical to best assure a smooth transition and successful result. The experiences may appear daunting, and at times it can be frustrating and

time consuming, but in the end, if properly done and coordinated, your organization can enter the Chinese market poised to take advantage of the vast human and capital resources available in the PRC.

If you are interested in learning more about U.S. Tax Exempt Organizations Doing Business in China, contact Richard Bar, GKG Law, P.C. at 202.342.6787 or rbar@gkglaw.com.