

# Import and Export Strategies for U.S.-China Trade

By William R. Dodson

3 October 2002

Deloitte & Touche Managing Tax Partner Alan Tsoi and Tax Partner Lili Zheng presented a scorecard on China's progress on its commitments to the WTO. They also shared common joint venture structures Chinese law sanctions for Foreign Invested Enterprises (FIEs) who wish to tap the China market for opportunities. Deloitte & Touche was a Corporate Sponsor of the China Trade Conference.

Tsoi offered that some of the investment channels foreign companies can use include:

- ☒ Joint Venture (JV) trading companies
- ☒ Wholly owned trading companies in a free trade zone
- ☒ PRC (People's Republic of China) holding companies
- ☒ And representative offices of a foreign company

Tsoi said that within three years "trading and distribution rights such as wholesale, retailing and franchising will be open in three years." In the first year of China's accession to the WTO, the PRC will permit foreign companies to establish joint ventures. In the second year of accession, foreign companies can own majority equity share in joint ventures. Within three years of accession, foreign companies may establish wholly-owned subsidiaries.

Tsoi presented several models for foreign-owned enterprises to invest in China. One model offered a FIE a joint venture with a Chinese company. The joint venture sets up a trading company in a Free Trading Zone (FTZ) like Shanghai or Shenzhen, which then sells to Chinese customers. The FTZ company can set up non-operating offices anywhere in China; however, the offices "cannot sign contracts nor participate in any profit-making activities." Other joint venture structures involved FIE's selling directly to Chinese Third Party distributors for sale inside China; a JV company in which the FIE maintains a minority stake in the company, effectively becoming a "silent partner;" and a joint venture that sells its goods to the Chinese partner for distribution and sale inside China.

The PRC has come to scrutinize inter-company transfers more closely, Tsoi said. Indeed, "what we in America call 'tax planning' is considered 'tax avoidance' in China." The key, he underscored, is "Documentation Documentation Documentation." The PRC expects for ten years after filing tax statements to be able to audit the records of inter-company trading firms.

Lili Zheng presented several holding structures for foreign companies investing in China. The Basic Holding Structure sees an American firm with a stake in a Chinese company. This structure has the advantage of a minimal capital investment that effectively requires the joint venture rent a space that meets the PRC's minimum requirements.

An Intermediate Holding Structure has an American company vested in an offshore holding company (eg, a tax haven, Maritius or Hong Kong), with the offshore company having a minority stake in a Chinese company. This structure is best for taxation purposes for the American company, and also expedites mergers and acquisitions (M&A) that involve the joint venture. Typically, change of ownership in China can take some time to move through regulatory channels. An offshore holding company, however, can sell its shares immediately, freeing up the joint venture to move forward in the M&A process.

Zheng explained that an IP (Intellectual Property) Holding Structure is more complex than the previous models. An American company invests in an Offshore holding company, which maintains a contract for Research and Development with a Chinese-owned company. Meanwhile, the offshore company keeps a marketing and sales agreement with a Hong Kong-based company, to control the use of the intellectual property the American company licensed to the offshore company for use in China.

Of course, in the next five years, as China meets the 124 commitments its made to the WTO, there will likely be less and less need for business structures that insulate foreign companies from -- rather than embrace -- the full potential of the China market.

*William R. Dodson is Managing Director of Silk Road Communications, L.L.C., an international markets research consultancy that advises companies on how best to develop their businesses for success in China and the West. He is a Managing Editor of **The China Alert**, a contributing editor of the American Management Association's (AMA) **MWorld Journal of Business Management**, and writes the weekly column "The Cultured Business", found at [www.silkrc.com](http://www.silkrc.com) He can be reached at [wdodson@silkrc.com](mailto:wdodson@silkrc.com) or +1 (847)722-7817.*

