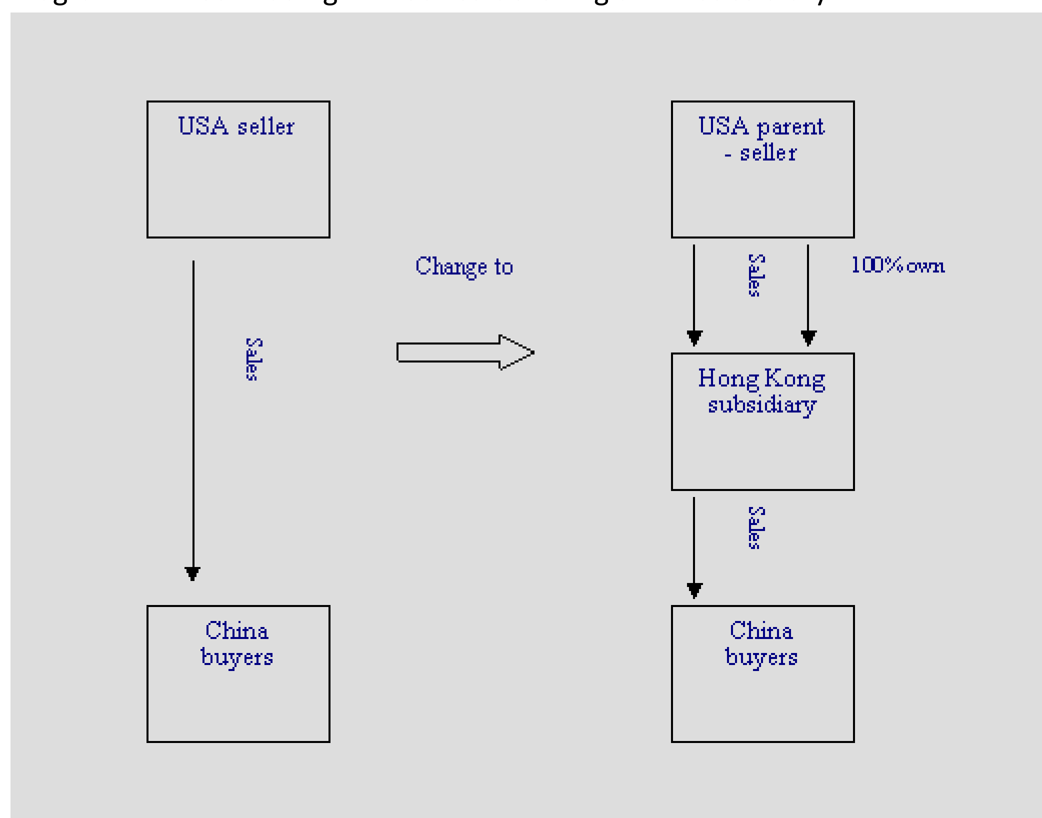
HOW TO SELL GOODS INTO CHINA?

This article illustrates how to use a Hong Kong Trading company in order to achieve tax efficiency to an overseas trader that sells its products into China. Many overseas suppliers these days selling their products directly to China either might have set up their own subsidiary in China or not. Under both circumstances, one may find several advantages to use an intermediate Hong Kong company to undertake the trading transactions with the Mainland China. First, we shall look into the direct trading business where the overseas supplier sells directly to the China buyer. In our examples, we use USA for instance (equally applicable to other countries) as overseas seller for illustration purpose.

Diagram 1: Direct trading without establishing a PRC subsidiary



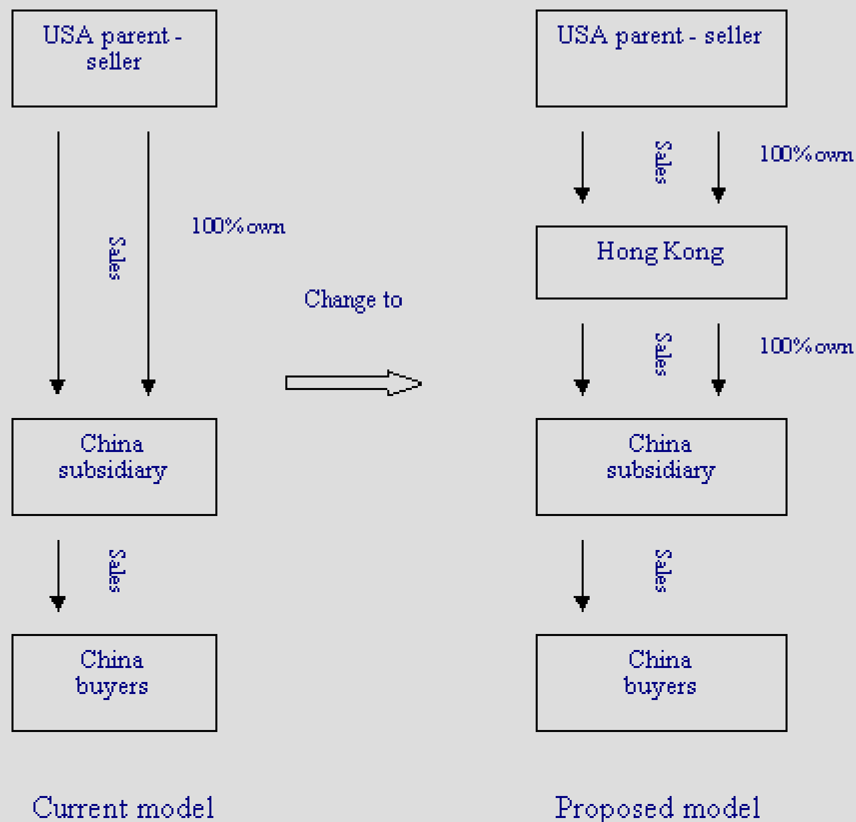
This model is characterized by having the Chinese buyers or independent third party importer responsible for importing goods into China and arranging the payment for sales proceeds out of China. The weakness of this trading model is that it is difficult for the overseas seller to expand its market share without sufficient distribution channels. To save home tax to overseas seller, it is advisable to add a Hong Kong trading company to buy from US seller and in turn sell to China buyers as an alternative.

The advantages for doing this can be summarized as follows:

Shifting profit from home country to HK- Trading profit reported in HK trading company attracts very low tax merely 16.5% on net profit, or even wholly exempt if offshore source profit can be proven. It is here worth to highlight the HK's "Territorial Source Tax Principle" that only profit derived from HK is taxable in HK. Profits derived from offshore trading transactions are tax exempt subject to proof of offshore income source. Transactions derived from Mainland China are classed as offshore in terms of HK tax perspective even though HK is a part of China. Buying from USA and selling to China could be, prima facie, construed as offshore trading transactions that are tax exempt in HK. It is crucial, inter alia, that no HK customers nor suppliers are involved to achieve offshore status.
Preventing profit repatriation to home country - Trading profit can be retained in Hong Kong that prevents immediate home tax for trading profit. However, money can be pushed back into US parent company by way of loan as an alternative to dividend payment.

Unlike China, there is no withholding tax in HK for profit repatriated back to the US parent company.

Pragmatically, most Chinese domestic buyers could find it easier to pay sales proceeds into a HK bank account than a US bank account.



Under trading model in diagram 2, the US parent first sells to its Chinese subsidiary that in turn sells to end buyers. It will then likely be the Chinese subsidiary that imports good into China, receives money from domestic buyers within China and pays the purchases proceeds out of China. Under the company structure where US parent holding 100% Chinese subsidiary directly, dividend paid out of China subsidiary will attract immediately the home tax to the parent company in US. Because of foreign exchange control in China, there is no alternative means to push money back to the US parent other than dividend payment and purchases proceeds. In order to relieve the harshness of the company structure, it is worth to add HK Company as intermediate holding company between US parent and China subsidiary.

The advantages of applying this proposed model are summarized as follows:
Shifting the profit to HK from US and China thru trading prices – HK takes the lowest tax 16.5% of net profit or no tax at all either. Contrast the income tax rates in China:

25%, US: above 30%. Transfer pricing issues must be monitored and handled carefully. Overly transfer pricing may trigger concerns from the tax authorities. Dividend out of China subsidiary to HK holding company is tax exempt in HK. And there is no withholding tax in HK neither for dividend repatriation to the US parents. This prevents immediate home tax for dividend paid out of China subsidiary.
Hong Kong subsidiary, instead of leaving it dormant, could also be used to deal with directly China buyers that are capable of importation and remitting payment out of China (see Diagram 1). This relieves the Chinese subsidiary from dealing with harsh Value Added Tax system in China. Further, it enables the overseas seller to take out whole of trading profit from China to HK and accommodates a more flexible trading model.

Any tax planning might involve risk of drawing concerns from tax authorities or effecting anti-tax avoidance provisions. The above is only for your information but not professional advice, please consult professionals before you implement any of the above information.