REP OFFICE VS WFOE IN CHINA

An investor might be puzzled to choose setting up a Representative office versus a Wholly Foreign Owned Enterprise (WFOE) in China. How does it differ between a Rep office and a WOFE ? This article outlines the key factors and differences foreign investors should consider while they decide on which establishment is more appropriate to their circumstances.

Representative office (RO)

A foreign RO by itself is not a legal entity as defined by Chinese law, but only a branch office of the foreign entity. Hence, it cannot directly employ staffs, but needs to engage a local labor agent to employ staffs under special employment arrangements. RO is the most simplest form of establishment in China. Its business scope is restricted to communication works with business parties, promotion of business and/or gathering market information for its foreign investor. Usually, a Rep office is established by exporter sourcing goods from China suppliers to engage a small team of quality control that is inspecting goods before loading shipment. A RO is prohibited from earning direct income from the domestic markets. The advantages of establishing a RO are swift setting up, low entry cost, no capital investment required, and simple operations to manage. On the other hand, RO is restrictive in business scope, is prohibited from activities earning domestically, is lack of flexibility for business expansion, and becomes expensive to operate in the event of growing operations. Business tax and corporate income tax are chargeable based on the operating costs of the RO. All money pushed into China will eventually become taxable under RO establishment. It is not interchangeable in legal form between a RO and a WFOE.

Wholly Foreign Owned Enterprise (WFOE)

To contrast, a WF0E is a legalized enterprise in China, that enables it to earn direct income domestically. A WFOE can be engaged in service, trading and manufacturing sectors, provided business scope is pre-approved by the authorities. It can directly employ its own staffs as opposed to RO. A WFOE statutorily requires minimum capital investment, the amount of capital depends on the degree of business scope. Therefore, the wider the business scope, the more capital is required. Consultancy service WFOE might probably need the lowest capital requirement. In contrast, a manufacturing WFOE might need the highest capital requirement. Also, the capital requirement varies on locations in China. Bigger city or province might request more market entry requirements than a smaller town.

To put it altogether, WFOE establishment allows more flexibility in business scope, can earn income domestically from China, if properly managed, can save operating costs as opposed to RO.

A comparison table for illustration purpose :		
	RO	**WFOE**
Market entry	No capital	Min. capital required
Setting up time	**2 –3 months**	**3 - 4 months**
5% Business tax basis	Operating costs	Actual revenue (service)
Corporate income tax basis	**Operating costs**	**Actual profit**
Staff employment	Indirect employment > Fee to labor agent: about RMB300 monthly per head	Direct employment > Save cost to labor agent
Management	**Chief representative**	**Legal rep, 2 additional directors (optional) and a supervisor (a must)**
Income derived from China	Prohibited	Yes
Business scope	**Restrictive**	**Pre-approval required**