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All's well that ends well

How to close down a business in China

When doing business in China, preparation is everything. As legally winding up a company can be just as time-consuming as establishing one, it is advisable to consider your options and prepare for phase-out well in advance. Keeping the requirements in mind from the beginning will help make this process as smooth and cost-efficient as possible.

Legal experts at the EU SME Centre have recently compiled a comprehensive guideline on the topic to help SMEs achieve just that. The following will summarise their advice on the voluntary closure of a company, as this is the most common exit option for foreign businesses. The guideline covers other ways of liquidating a company as well, however, including enforced closure and bankruptcy, so be sure to download it for free on the Centre's website.

Closing down a representative office

As a representative office (RO) is not allowed to engage in any profit-making activities in China, shutting it down is a relatively straightforward process. It can be divided into two parts:

1.) tax clearance and cancellation of the tax registration;
2.) deregistration at the State Administration of Industry and Commerce (SAIC).

Even though tax clearance might appear simple for an RO that has not generated any profits in China, it usually takes much longer than expected. Audits by certified public accountants tend to be very thorough and collecting and checking all necessary documents takes time. ROs will often be required to reimburse taxes during the process – usually unpaid income taxes for the office's (foreign) employees or taxes on unreported income. These infractions will draw out the auditing process even more. Once the notice of cancellation of tax registration has been received, the customs certificate has been cancelled and bank accounts have been closed, the official deregistration of the RO at the SAIC can take place. To fully close the office, all other documents issued by government authorities will have to be cancelled as well. In all, closing down an RO usually takes three to six months.

Closing down a wholly foreign-owned enterprise

The starting point for closing down a wholly foreign-owned enterprise (WOFE) is the decision by the shareholders to do so. According to Chinese law, any of the following legal reasons must be given for this decision:

- expiry of business operation;
- poor operations and serious losses;
- incapacity and serious losses due to force majeure;
- any termination reason given in the WOFE's articles of association.

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Once the decision has been made, a liquidation committee has to be formed to manage the process. The members are made up of representatives of the shareholder companies with the legal representative of the WOFE acting as person in charge. The duties of the committee are as follows:

- clearing the company's property and verifying creditor claims;
- preparing an inventory list and balance sheet;
- formulating principles for property evaluation and calculation;
- drafting a liquidation plan;
- notifying known and unknown creditors in writing and through public announcements;
- paying overdue taxes;
- clearing credits and debts;
- preparing a liquidation report;
- participating in civil lawsuits on behalf of the company.

One of the main tasks of the committee will be to deal with remaining creditors. Whereas known creditors have to be informed about the imminent closure of the WOFE directly, a detailed announcement has to be placed in a provincial-level newspaper for the benefit of any unknown creditors. After the deadlines for the reporting of any claims have passed and they have been verified, the liquidation committee draws up a liquidation plan with payments being prioritised in the following order:

1.) expenses incurred during the liquidation, such as management costs, lawsuits or arbitration;
2.) salaries and social insurance contributions for employees;
3.) taxes;
4.) secured credit rights;
5.) unsecured credit rights.

If the assets prove to be insufficient to cover all costs, the committee can apply for bankruptcy at the appropriate People's Court.

For more free information on representative offices, WOFEs and joint ventures in China, please see the following documents on our website:

- *Diagnostic Kit: Ways to Enter the Chinese Market*
- *Report: Establishment and Operation of a Representative Office in China*
- *Webinar Recording: How can Foreigners Establish an Office in China? WOFEs and Representative Offices*
- *Guideline: Establishment of a Foreign-Invested Enterprise in China*
- *Guideline: Due Diligence for Joint Ventures, Mergers and Acquisitions in China*

After the liquidation of the company, the employment contracts with the employees can be terminated. 180 days after the establishment of the liquidation committee, the liquidation

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report has to be submitted to the registration authority. Following this, the company books will be audited by a certified public accountant and all outstanding taxes need to be paid before the final tax clearance certificate can be issued. Finally, the WOFE can apply for the cancellation of the tax registration at the local and national tax bureaus as well as the cancellation of the registration at the SAIC. Only then can the remaining funds be divided amongst the shareholders. Depending on the business scope and the completeness of the necessary documents, the whole process normally takes six to twelve months.

Closing down a joint venture

The procedures for closing down a joint venture (JV) are similar to those for winding up a WOFE, differing only in details. Firstly, there are two additional acceptable reasons for the dissolution of a JV: the failure of one of the partners to fulfil the obligations prescribed in the agreements and the inability to achieve the business operation objectives and development in the future. Secondly, the decision to close down the JV has to be made unanimously by all directors present at the respective board meeting. And lastly, all accounting books and materials have to remain in the custody of the Chinese partner once the process has been completed successfully.

Taxes and suspension of staff

The Chinese authorities check any company's tax records meticulously before issuing a deregistration certificate. This usually involves an audit of all tax and accounting data of the past three years, including but not limited to accounting books, contracts, original receipts, invoices and so on. It is therefore highly recommended to familiarise oneself with the clearance procedures, requirements and timelines.

Authorities and local governments also keep a watchful eye on layoffs, especially mass redundancies. Failing to handle these issues with adequate care can lead to delays in the business exit, especially if disgruntled employees decide to take legal action. Liaising with the local labour department and trade union in due time to arrange for proper procedures will help, as will careful negotiations on tailored solutions with all employees.

You will find many more resources on this and related topics on the website of the EU SME Centre, including guidelines on dispute settlement with Chinese companies and the importance of internal labour rules as well as recordings of webinars on contract terms and due diligence to protect your company's assets. For any questions, please contact the Centre's legal team.

The EU SME Centre is a European Union funded initiative helping SMEs get ready to do business in China. Located in Beijing, the Centre provides practical information, confidential advice, and training in the areas of business development, legal issues, standards and HR to facilitate market access for European SMEs. The Centre also acts as a platform to facilitate coordination amongst Member State and European public and private sector service providers to SMEs. To find out more, visit: www.eusmecentre.org.cn

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