For every roughly 100 China WFOEs and Joint Ventures (total) my firm helps set up in China, it does one Representative Office. Why so few Rep Offices, when it is generally agreed they are the easiest entity for foreigners to form in China? Because the inherent limitations on China Rep Offices mean they seldom make sense.

Rep Offices “represent” in China the foreign company back home. Rep Offices are not a separate legal entity; they are the China representative of the foreign company. Most importantly, they are not allowed to engage in profit making activities. Chinese law limits them to performing "liaison" activities.They cannot sign contracts or bill customers. They cannot supply parts and after-sales services for a fee. They simply cannot earn any money in China or take any payments from a Chinese person or business for any reason.

NOTE: This post does not discuss branch offices for banks, insurance companies, accounting firms or law firms, all of which **are** permitted to engage in profit-making activities in China.

Rep Offices are pretty much limited to engaging in the following:

-- Conducting research.
-- Promoting their foreign company.
-- Coordinating their foreign company’s activities in China.
-- Other activities that do not and are not intended to generate a profit.

Because forming a Rep Office in China is faster, cheaper and easier than forming a Wholly Foreign Owned Entity (WFOE), companies oftentimes consider forming a Rep Office in China to test the waters there, with the intention of switching over to a WFOE once it becomes clear China will be viable for them. We generally discourage this because “switching” from a Rep Office to a WFOE is not really a switch at all. It involves both shutting down the Rep Office and forming a WFOE pretty much from scratch. Because the cost of forming a Rep Office, shutting down the Rep Office, and then forming a WFOE, will be considerably higher than just forming a WFOE, forming a Rep Office with the later intention of forming a WFOE seldom makes sense. Companies will usually be better off just biting the bullet and forming the WFOE straight away.

Other times, companies have come to my firm believing they need a China Rep office because they need a Chinese entity to sell their product into China. Oftentimes though, these companies can sell their product into China without having to create any in-china footprint at all.

There are definitely times where a Rep Office makes sense. By way of one example, my firm set up a Rep Office for a US company that sells US made equipment for around $2 million each. This company has no plans to start manufacturing its equipment in China so there would be no need to form a WFOE for that. It already had an arrangement with a Chinese company to repair its equipment sold into China, so no need to establish a WFOE for that purpose either. This company merely wanted an on the ground China presence to improve its sales and to let its customers and potential customers know it is serious enough about China to commit to having an office there.

There are three basic requirements for forming a Rep Office:

1. The most important requirement is that there must be a lease on an **approved** space for a period of at least one year beyond the approval date of the Rep Office. Care should be taken with this requirement, since many jurisdictions accept leases only from a small group of approved office buildings. Shanghai, for example, is one such jurisdiction. The lease must be registered, which can also cause problems in some jurisdictions.

2. There must be a designated Chief Representative who will manage the affairs of the Rep Office.

3. There must a foreign entity (typically a limited liability or a corporation) that the local office represents; private individuals and partnerships cannot establish a Rep Office in China. In addition, some jurisdictions in China do not allow newly formed entities to form a Rep Office.

The local approval authorities usually issue their decisions on Rep Office approval within around thirty days, at which point the Rep Office must do many of the other things typically required of businesses in China. However, in some areas, the decision can take much longer, depending on the whims of the local officials.

There are two major issues that make working with Rep Offices unattractive:

1. Even though Rep Offices are not permitted to earn income in China, they are nevertheless subject to taxation.There is a 10% tax on the GROSS EXPENSES of the Rep Office. If the Rep Office is large and has a number of employees, this tax can be quite high.

2. A Rep Office is not permitted to directly hire Chinese nationals. All hiring of Chinese nationals must be done indirectly through contracting with a Chinese employment agency such as FESCO. Recent changes in the Chinese labor contract law have made such contracts extremely unattractive. Rep Offices can directly hire foreign nationals.

The bottom line on Rep Offices is to think before you leap and not get seduced by their relative ease of formation. Every once in a while my firm will get called by someone who formed a Rep Office (usually through a formation company) within the last year or so who tells us they are now ready to "switch over" to a WFOE so they "can start making money" in China. These people believe this "switch" will involve little more than a one page notice of change and are shocked to learn that it will actually involve a shutdown and a new formation. Do not let yourself become one of "these people."