5.8. Exchange Rate Implications

As a foreign-owned entity, you will be influenced by the exchange rates for your imports, exports, dividends and also services.
In the past, the US Dollar has been pretty stable compared to the Chinese Renminbi, but lately the tendency towards more volatility is increasing.
In the year 2017 the exchange rates for

- USD to RMB changed around 5%
- EUR to RMB changed around 8%

If you have, therefore, a choice regarding the currency you should consider which one might be the less volatile and more reasonable one for your business setup in the near future.

Planned exchange rate vs. real exchange rate

To provide a stable calculation basis, international companies often define planned exchange rates and base their operations on them. Due to the volatility of the exchange rate markets, they do often not match with reality, though, and sudden unplanned events can heavily influence the tendency:

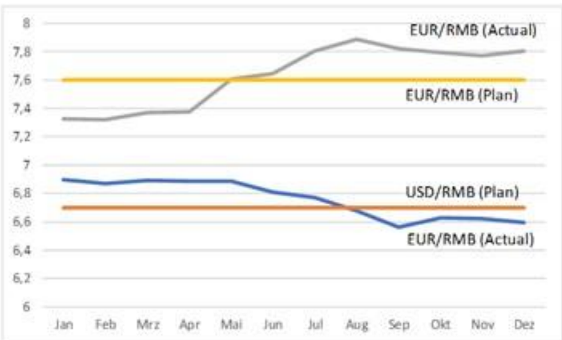

Figure 10: Exchange Rates Deviation from Plan Rate

Pricing systems often are maintained with one base currency, e.g. the Euro, and depending on the sales currency they calculate the sales price based on the plan exchange rate.

Plan exchange rate vs. actual exchange rate: relevancy for intercompany business

For intercompany pricing from a group perspective there is no big influence if we neglect possible influences on taxes and fees.
For deviations between the plan exchange rate and the actual exchange rate, it just moves around exchange rate losses or earnings within the group. Example:

- Plan exchange rate is 1 EUR = 10 RMB
- Actual exchange rate is 1 EUR = 7 RMB.
- One good that is priced with 10 EUR will be sold to the Chinese company with the plan exchange rate:

  $$10\,EUR * 10\frac{RMB}{EUR} = 100\,RMB$$

- As a comparison, if the actual exchange rate would be used, this would equal

  $$10\,EUR * 7\frac{RMB}{EUR} = 70\,RMB$$

- The price difference between both types of calculations is 30 RMB.
- When using the plan exchange rate to calculate the sales price, the Chinese company has to pay 30 RMB more than with the actual rate and therefore has an exchange rate loss.
  When using the actual exchange rate, the influence on the local company is zero while the selling entity is receiving a lower amount, leading to an exchange rate loss on their side.

As a summary, it is pretty clear that exchange rate differences will have an influence by exchange gains and losses on your group results. At the same time, for intercompany pricing it does not matter if the planned exchange rate or the actual exchange is used since with this the exchange rate earnings or losses just get moved around within the group.

Exchange rates and external business

This changes though, as soon as you start selling goods to external customers since this will lead to money inflow or outflow of the group. When you are doing business in foreign exchange with third parties, you should ensure that a reasonable exchange rate is being used during calculation since this will directly influence your operations result. At the same time, if the quoted price towards the customers will be recalculated every time according to the current exchange rate, this might lead to strong price fluctuations and a customer who might be a little irritated.
Most companies, therefore, make a price list once a year and calculate the transfer prices in other currencies with a plan exchange rate to keep it stable.

Common pitfalls and tips

- If a company offers you two different currencies to pay for their services or products, ask for both prices.
  Depending on their internal pricing system you might be able to get a serious discount when their plan exchange rate deviates from the real exchange rate a lot.

- Some ERP systems usually use one or several price tables for pricing and all prices are maintained in one currency. Be aware of the risks that you bring to yourself regarding low-margin products if you choose that the conversion should be based on standard exchange rate. Even small deviations between the planned exchange rate and the real exchange rate can make single business transactions suddenly unprofitable.

6. Company Taxation

The taxation of companies in China is in a constant development: During the recent years there was at first the transition from business tax to VAT, followed by several changes in the VAT rates, e.g. in:

- The year 2018, when the general VAT was reduced from 17% to 16%
- Followed by another reduction in 2019 from 16% to 13%

Adjustments also in the taxation environment can happen quite sudden with just a few weeks since the announcement until implementation.
This chapter will focus on the most common taxes, e.g.:

- Corporate income taxes
- VAT and VAT surcharges
- Withholding taxes for China-sourced income if the invoicing entity does not have a physical presence within China.

Additionally, it will give you an outlook on different ways for profit repatriation to the shareholder of your company by using commonly-used approaches and comparing the tax impact.