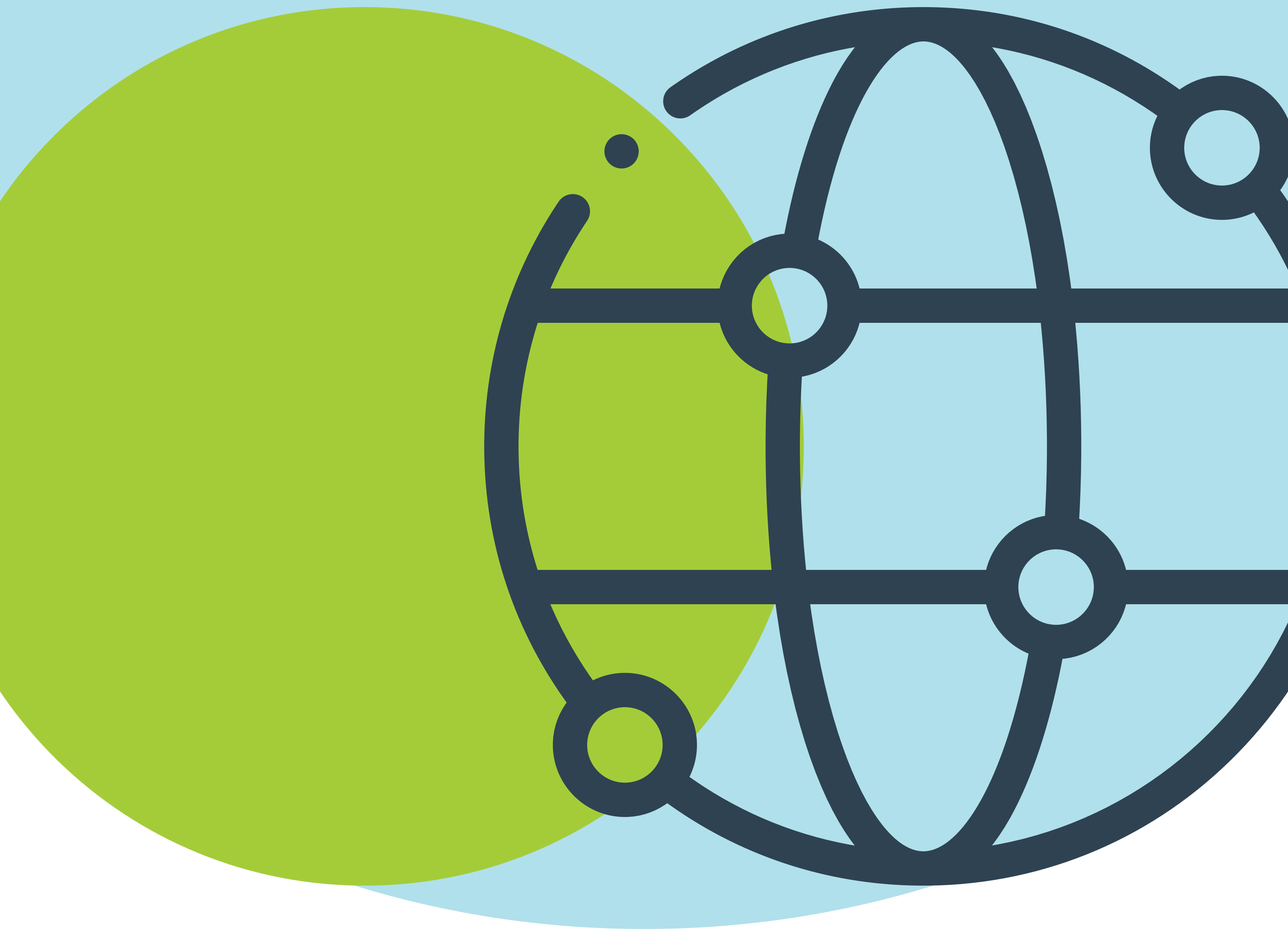
# What to Consider When Opening an Office *in Another Country*



a whitepaper from 8020 CONSULTING

# INTRODUCTION

As U.S.-based companies seek to expand globally, they may develop an interest in setting up remote sales offices to act as ambassadors of the company and establish trade relationships and contacts in far-off markets. Though it sounds as easy as renting an office, hiring local staff and kicking off some marketing – optimistically all within a few months (of course) – a variety of complications may extend the timeline.

In this paper, we'll refer to our experience with an entertainment company that wanted to open a sales office to expand its business in China. The company had already developed markets in North & South America, as well as in Europe, and Asia was viewed as the next growth opportunity for its products. The first step was the sales office setup and local marketing campaign. Initially, the venture was planned for a nine-month launch. However, company leadership was surprised to learn that it might take twice as long as thought.


***Considerations We'll Cover:***

1. Legal Entity Registration
2. Taxes
3. Banking

# LEGAL ENTITY REGISTRATION

## *Does a legal entity need to be created in the foreign country for the sales office?*

Setting up a sales office in some countries may require creating a local legal entity in the country. This is often done to secure a business license, register as a tax-paying entity (even when no tax is going to be due and a null tax return is required) or comply with other government regulations such as securing a bond to cover customer deposits.

**Will the foreign sales office be considered a branch of the main company or a subsidiary of it?** Both have pros and cons. A branch offers more control but also more possible liability; a subsidiary provides more protection but at a cost.

**Are there certain capital requirements, the need to establish investment shares or required documents for ownership interest?** These are often dictated by government requirements.

Submitting the paperwork and completing filings with the local government to create a legal entity can require attorneys and tax experts and may take several months, depending on location and complexity.

*This process took several months for the aforementioned entertainment company. The legal team contracted with local experts who understood the language and intricacies of the country, district and even city-level tax laws and government regulations.*

*A company chop – a stamp of the company name used on official documents – had to be created to authorize all documents. (An interesting paradox is that you need a registered company to get a company chop, but you also need a company chop for the documents to register a company.) Because the chop can bind the company to contracts without any other signatures, policies for safeguarding and monitoring the chop were required. The chop spent a lot of time in a physical safe, and a log was created for every time it was used.*

*The company ultimately decided to make the representative office a subsidiary of the U.S. parent company to protect long-term revenues from local taxation. This choice had further impacts, such as increased setup costs, reduced scope of what the company could do and the need to contract more senior local leadership for the subsidiary.*

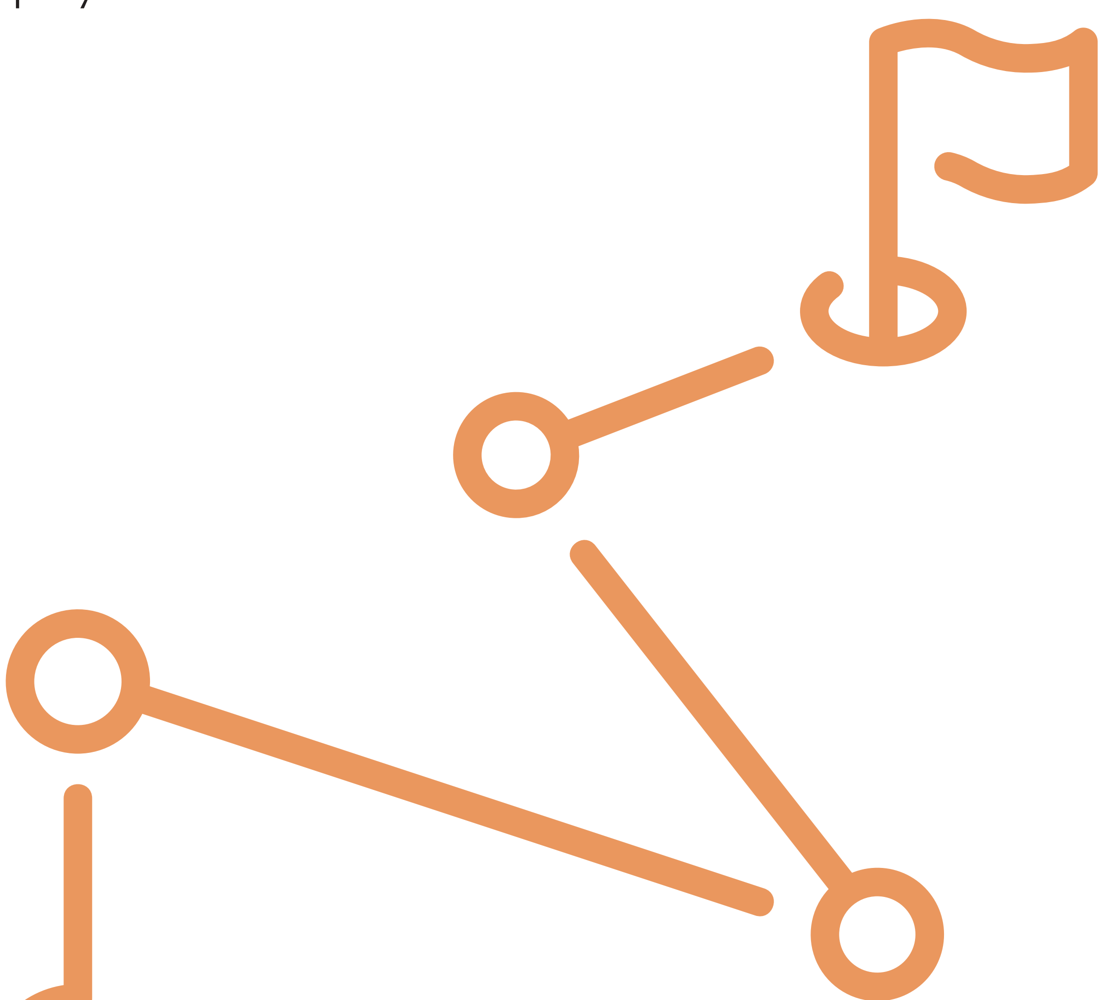
# TAXES

## *Does the U.S. and the foreign country have an existing tax treaty? How does it treat foreign sales by the U.S.-based sales office?*

The foreign sales office tax strategy should be established at the outset. Often the local sales office may only be empowered to act as a representative of the U.S. company – facilitating contracts and marketing efforts – but must not enter itself into those sales contracts to maintain its beneficial tax status.

**Are there tax benefits that should not be overlooked?** Sometimes it may be advantageous to create a legal entity for the company in one tax district while creating a separate legal entity to hire employees due to favorable tax treatment or rebates in another separate nearby district.

**If taxes are due, will they be based on a set fee, a profit or cost-plus model or an expenditure formula?** Setting up the most advantageous tax foundation should consider not only the short term but also the long-term strategy for the company. A smaller sales office may start out with minimal to no tax liability, but that may change after a set government-defined period or level of local sales by the parent company.



The entertainment company initially created a legal entity in an industrial district in Shanghai for favorable tax treatment. The company had to subcontract to hire employees through an agency, as neither the foreign company nor the representative office could directly employee local workers. Taxes were based on a percentage of expenditures of the subsidiary as no revenue would flow through the subsidiary to mitigate exposure to Chinese tax on revenue.

As a result, the sales office had to be careful to only act as a coordinator and brand ambassador for the parent company and never directly enter into sales-related contracts itself. The parent had to work with Chinese distributor companies to sell its product in the market, limiting control and profit margins. This meant slower response times and more paperwork flowing from Chinese business partners and the home office, sometimes hampering the business.

Eventually, the company decided to move to a wholly foreign-owned enterprise (WFOE) as the market grew and direct-to-consumer sales were considered. This move also allowed conversion of the contracted employees to direct hires. The company created a second legal entity in another tax district of Shanghai, which had more advantageous government policies and reporting requirements. The subsidiary still maintained a hands-off approach to sales revenue to avoid income taxation but would be allowed to accept payments from local customers. This was important, as China's currency controls and banking regulations made payments from everyday citizens extremely difficult to bank accounts outside of China. This restriction made direct-to-consumer sales a non-starter without the WFOE acting as a point for collection.

A trade off was that taxes would be paid on a cost-plus model. The local Chinese subsidiary essentially charged the parent company in the U.S. a predetermined profit on its operating costs that had to be settled periodically. This change also involved preparing transfer-pricing documentation to be submitted for approval by the Chinese Finance ministry as well as shuttling currency in and out of the country to repay these intercompany debts. The subsidiary also had to issue Fapiao, official paper tax documents similar to receipts, to its consumer customers. Issuing Fapaio requires a special-issued government printer that is linked to the Chinese tax system. New policies and safeguards had to be instituted at the company around this process.

# BANKING

## *Will the business require a local bank account?*

Perhaps the initial plan is to receive customer transfers via credit card transactions and use the foreign exchange servies offered by the card network. As sales grow, it may be advantageous to receive payments in foreign currency to avoid or reduce foreign exchange fees on individual transactions. Maybe a local bank account is required to take part in local merchant networks, as the country's currency controls make international transfers difficult for everyday customers.

Statutory requirements in some countries may require a local bank account for tax or other government-filing payments. Payroll-related employee social security program withholdings may be required to be deposited into a local bank account registered under the US company or subsidiary name.

**Are certain bank networks preferred due to geography, such as local cash deposits and delivery to retail locations?**

Setting up a bank account can take up to half a year or more in some countries due to paperwork and submissions of physical documentation of company officers' identification (e.g., signatures and notarized passport copies). A local legal entity may be required prior to setting up a bank account as well.

Going back to our example in China, at the time, the local laws required that the entertainment company maintain two bank accounts with a bank that had physical branches in the country. One account was required in the local currency to pay vendors for administrative costs like rent and payroll. The other was for any required foreign capital investment.

As the entertainment company's existing banking partners did not have a well-built network in Asia, an RFP process was carried out to identify a suitable bank in the region for the China office as well as expansion to other Asian countries in the future. Of course, this took additional time that extended the planned rollout of the office. Opening the bank accounts took almost six months, as notarized forms and identification had to be physically carried to the local bank office in Shanghai.

A separate bank account had to be opened later at a state-government-sanctioned bank for employee- and company-related social security payments as well. The initial bank was chosen for business reasons, but it was not on the established government list of approved state-owned banks for the social security payments.

# Bring in the *Professionals*

These are a few of the issues that should be considered when setting up a sales office in a market outside the U.S. Careful planning at the onset will reduce possible pitfalls and pains as the business grows and expands in those markets. If you need support, 8020 Consulting can help. With a team of nearly 100 professionals headquartered in Los Angeles and capable of working remotely to serve companies across Southern California, we can quickly assess and respond to your unique requirements and mandates. Even in this unique time of business, we are ready to apply our commitment to the value of “continuous improvement” and “focus on the critical” to generate immediate results.

Contact us today to support your project goals—**now is the time**.

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