



Country Specific Issues in EB-5 Practice – China

By Yi Song, Esq¹.

The People's Republic of China is one country that EB-5 practitioners and related EB5 professionals cannot afford to neglect. The top 5 countries² in 2012, for EB-5 alien entrepreneurs are: China, South Korea, Taiwan (region), Iran and Venezuela. Chinese investors account for an overwhelming 70% of the total EB5 investment, followed by 9% from South Korea, the rest of the top 5 countries each account for less than 3%.

Despite the recent statement from USCIS, at the May, 2012 Stakeholder's meeting in California, that EB-5 adjudication standards is not country specific, judging from recently issued Requests for Evidence (RFE), USCIS has constantly questioned the basis of the capital obtained through lawful means from the investors from China. The RFEs show that there is insufficient understanding of Chinese law. The purpose of this article is to provide a few practical guidelines in the areas of Chinese law that have the most impact with EB-5 practice.

Who are you dealing with? - A Brief Introduction to Chinese Immigration Agency Industry

At the May 2012, USCIS stakeholder meeting, the agency advised that an estimated 90%-95% of all I-526 petitions are associated with regional centers. This would mean the majority of the direct foreign investments generated by the EB-5 programs have been utilized for large-scale projects, with an average benchmark of \$15,000,000 for raising capital, or 30 investors with a minimum EB-5 investment amount of \$500,000. For a project of this size, EB-5 practitioners rarely deal directly with the investors. They work with Immigration Agencies in China.

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² Statistics report published by IIUSA dated March 2012.



The immigration agencies have the monopoly in the immigration industry in China. The investors, who often speak little English, if at all, approach the agencies for immigration consultation, project recommendation, document collection, translation and in some cases foreign currency exchange services. Because of the language barriers, the clients with immigration needs are easily defrauded. The immigration agencies, or in Chinese “Zhong Jie”, suffers a notorious reputation.

It is not surprising, therefore, that immigration agencies are heavily regulated in China. The governing administration is the Bureau of Entry and Exit Administration under the Ministry of Public Security. According to the Measures on the Administration of Intermediary Activities of the Exit and Entry for Private Purposes³, Article 17, the immigration agencies are required to obtain the Immigration Agencies Service Business License. The license is usually valid for five years if issued by the provincial level government. The agencies are subject to an annual evaluation by the local public security bureau.

Some EB-5 practitioners have encountered the practice of “authentication”. Here Chinese immigration agents request proof via certified documents from the US Attorney of valid US incorporation, an approval letter for similar petitions, a specific cooperation agreement and professional qualifications. Such requests have led to the misconception that the Chinese agents are conducting their own due diligence background searches on the US law firms, project companies or regional centers. In fact, the agencies requesting such documentation from US Attorneys and entities are more likely to utilize such documentation for the purpose of renewing their own business license with the public security bureau in China rather than due diligence. In order to have a license successfully renewed, the agents are required to prove the genuineness of the immigration service they provide and that it does have a genuine working relationship with foreign immigration attorneys, capital raising project companies, or marketing consultants. Though for EB-5 projects working with Chinese immigration agents is the norm, it is not mandatory that a US entity must go through the agencies in order to obtain the EB-5 investors.

³ Measures on the Administration of Intermediary Activities of the Exit and Entry for Private Purposes, issued by The Ministry of Public Security and the State Administration of Industry and Commerce, June 6, 2001.



Do I have to Show Taxes? – China’s Taxation Systems

One of the common complaints from EB-5 practitioners is that investors from China do not have proof of tax payments. Though the EB-5 law⁴ requires alien entrepreneurs to show their tax returns for the past five years, USCIS does not seem to implement the rules rigidly. According to Article 8 of the People’s Republic of China Individual Income Tax Law, the employee’ income tax is withheld and filed by the employers⁵. The tax rate on individual income adopts the progressive tax rate ranging from 5% to 45%.

Due to the high tax rate, it is a well known secret that Chinese companies and high net worth individuals keep substantial income in their off-book records. USCIS usually does not require the reported tax payment reach the sufficient amount under Chinese tax law. In the I-526 petition to prove lawful source of funds the petitioner is advised to include any type of tax payment records. Chinese citizens do not file their own tax returns unless their annual income exceeds RMB 120,000 (USD 18,750)⁶. Chinese nationals can request the “Individual Income Tax Payment Certificates” or in Chinese, “Shui Piao”, from the local tax bureau.

In China, there are two systems in taxation administration⁷: the national tax bureau contributing to central government budget and the local tax bureaus contributing to the municipal government budget. Each tax administration collects different types of taxes. The national tax bureaus are often in charge of sales tax, value added tax, corporate income tax, customs duty, etc. The local tax bureaus are in charge of individual income tax, business tax, city and township property usage tax, etc.

⁴ 8 C.F.R. § 204.6(j)(3)(ii) personal tax returns including income, franchise, property (whether real, personal, or intangible), or any other tax returns of any kind filed within five years, with any taxing jurisdiction in or outside the United States by or on behalf of the petitioner;

⁵ People’s Republic of China Individual Income Tax Law, Article 8, Enacted by The Tenth National People’s Congress Standing Committee, XXXI Session (March 1, 2008).

⁶ Measures on Self-Declaration Rules for Individual Income Taxation, Article 2, State Administration of Taxation (November 6, 2006)

⁷ Information from the official website of State Administration of Taxation:
<http://www.chinatax.gov.cn/n8136506/n8136593/n9947392/10525325.html> (Last retrieved May 26, 2012 materials in Chinese)



Corporate Law in China

In recently issued RFE's for I-526 petitions, the registered capital, sole proprietorship, business bank account versus personal bank account are often questioned. This trend shows a lack of understanding of the Corporate Law in China. The People's Republic of China Company Law (or the Corporate Law) was overhauled in 2005 when the mandatory minimum registered capital amount was significantly reduced to RMB 30,000 (USD 4,688) ⁸ for limited liability companies in order to encourage entrepreneurs in the start-ups in the market.

The minimum registered capital is a unique concept under the Company Law in China. Basically, it is the seed money put down to initiate business operations. The purpose of the registered capital is to protect the interest of shareholders and the companies' business partners. Because the company is a separate legal entity, the principal of the company is not personally liable for all the debts and losses. To prevent aggressively risky business activities, the registered capital is reserved to cover the future losses and debts of the company. In recent I-526 RFEs, USCIS seems to confuse "registered capital" with the "current assets". Registered capital is not shown on the regular balance sheet or profit and loss statement; instead it is shown on the Capital Verification Report. The registered capital is not necessarily cash, it also can be intellectual property, equipment, land use right, property and labor.

Sole proprietorship, on the other hand, is not a separate legal entity. It does not shield losses and liability from the individual business owners. According to the newly amended Regulation⁹ of Sole Proprietorship in China, the business owner is entitled to all the profits and income, and is also personally liable for all the debts and losses of the sole proprietorship. If an EB-5 investors' investment capital derives from the income from a sole proprietorship, the indication is the business income may well be in the personal bank account of the business owner instead of a separate business bank account. The requirement for setting up a sole proprietorship is almost the same with the limited liability company; however, the registered capital is not mandatory¹⁰ for sole

⁸ People's Republic of China Company Law, Article 26, Enacted by The Tenth National People's Congress Standing Committee, XVIII Session (October 27, 2005)

⁹ Regulation of Sole Proprietorship in China, Article 2, State Council Executive Meeting 149th (November 1, 2011).

¹⁰ Regulation of Sole Proprietorship in China, Article 9, State Council Executive Meeting 149th (November 1, 2011).



proprietorship because the business owner is personally and severally liable for all his business liability and losses.

Banking Laws in China

China has foreign currency restriction rules. According to the Regulation¹¹ of State Administration of Foreign Currency, each Chinese national can only exchange maximum of \$50,000 dollars for personal consumption purpose. The EB-5 investors would use more than 10 foreign exchange facilitators to overcome the hurdles of the currency restriction. It is also common that the investors would utilize a friend or a currency exchange entity in Hong Kong, the Special Administrative Region (SAR) where the foreign currency restriction does not apply.

A recent change in banking rules¹² released by China Banking Regulatory Commission regarding loans for the purpose of individual investment is that the funds are directly deposited to the business counterparty's account. For example, if the investors claim to obtain a bank loan for the purpose of purchasing steel, the loan will be deposited directly into the steel seller's bank account. In the EB-5 context, some investors obtained bank loans for the purpose of expanding their business in China, however, the funds were later invested in the United States for the EB-5 program. In such cases, there are usually convoluted funds transfers through multiple bank accounts of different business entities. Each transaction needs to be well documented.

Another issue relating to bank transactions in EB-5 petitions, is where funds transfer among various business accounts. USCIS seems to question the scenario where the investment capital is transferred back and forth among different business bank accounts. For example, RMB 3,600,000 (approximately USD 560,000) is a loan issued by the petitioner's company. One day before the funds were wired out to the petitioner's personal account, the exact same amount was deposited to the business account. It may seem the capital is not genuinely derived from the company's business income. The EB-5 practitioners shall be aware of the rules of corporate bank accounts. According to

¹¹ Information from the official website of State Administration of Foreign Exchange:
<http://fj.safe.gov.cn/110000/110000f0263005.htm> (Last retrieved on May 26, 2012 materials in Chinese)

¹² Temporary Measures regarding Individual Loan released by China Banking Regulatory Commission (February 20, 2010).



Administrative Rules on RMB Bank Settlement Accounts¹³, there are different types of bank accounts that a company is required to associate with its business activities. The regular business account is utilized only for salary distribution, regular business transactions and cash withdrawal. The company checking account is more flexible, it can be utilized for loans, other funds transfer and cash deposit.

In the EB-5 scenario mentioned earlier, it is likely that the company loan is transferred from the regular business account to the company checking account then subsequently transferred to the petitioner's personal account. The fact that the funds were transferred multiple times is not because the source of the investment capital is not genuine, but the usage of regular business account is so restrictive under Chinese law and the petitioner needs to transfer the funds from a regular business account to company checking account.

Property Law in China

The relevancy of Chinese property law in the EB-5 context is the land use right. First and foremost, the individual in China does not have right to the land¹⁴ except for certain land collectively owned by village and township, the individual has the right to use the land. The land use right can be transferred, sold, gifted subject to certain land purpose restriction. In some I-526 petitions, the investors utilize the land use right as collateral for the bank loan or the investors utilized the land use right as registered capital. The practice is completely in compliance with Chinese property law. In both cases for the purpose of the EB-5 petition to the USCIS, the land use right shall be appraised and evaluated by certified appraisal entities.

¹³ Administrative Rules on RMB Bank Settlement Accounts, Article 11 released by People's Bank of China (April 10, 2003).

¹⁴ People's Republic of China Property Law, Article 4, the Tenth National People's Congress Standing Committee, the V Session, (March 16, 2007).



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Marriage Law in China

The Marriage Law in China comes into play if the EB-5 investment is jointly owned by the investor and the spouse. According to the Marriage Law¹⁵ of People's Republic of China, marital property is property acquired by a couple or by either spouse during their marriage. Marital property is jointly owned by the couple. Utilization of the property is only effective upon mutual consent of the couple. All income earned by one spouse during the time of the marriage is considered marital property. To utilize the jointly owned property as EB-5 investment, usually a declaration signed by the investor and the spouse bears sufficient evidentiary value.

Conclusion

Given the fact that majority of EB-5 investors are from China, EB-5 practitioners should be familiar with the basic Chinese legal regime in order to better represent the investors in front of the USCIS adjudicating officers. As much as USCIS would like to avoid adjudicating based on country specific standards, it is inevitable that the investors from each foreign country present a certain pattern in the case scenarios. Due diligence research and background information about the investors' lawful source of funds proved to be effective to strengthen the EB-5 petitions.

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¹⁵ Marriage Law of People's Republic of China, Amended in April 2001 the IX National People's Congress Standing Committee, the XXI Conference, Chapter 3, Article 17.