

China Tax & Investment News

Regional headquarters in Shanghai can now do more for less

New regulation for foreign invested regional headquarters in Shanghai recently announced

Executive summary

Asia's growing role in the global economy has prompted many multinational companies (MNCs) to rapidly expand their direct investment in the region, which in turn triggered the need to establish regional headquarters (RHQ) to consolidate, hold and manage their operations. Traditionally, Hong Kong, Tokyo and Singapore are favorite RHQ choices for a variety of reasons. Lately, Mainland China has also joined in the race.

China started the race when the central government promulgated the first regulation on the establishment of foreign invested Chinese holding company¹ (CHC) in April 1995, but with rather stringent requirements and a high financial threshold. Some local governments lowered the bar by issuing regulations for the establishment of an RHQ requiring lesser commitments. For instance, the Shanghai municipal government issued the Tentative Measures for Encouraging Foreign Multinational Companies to Establish Regional Headquarters (the "Tentative Measures") in July 2002. Since then, more and more MNCs set up beachheads in Shanghai, taking advantage of its location, preferential policies and other benefits.

On 7 July 2008, the Shanghai municipal government revised and replaced the Tentative Measures with a new circular, Hufufa [2008] No.28 (hereinafter referred to as "Circular 28"). Circular 28 expands the business scope for newly established RHQ in Shanghai and promises a brand-new set of benefits (although the full details of the latter are still pending).

This issue of the China Tax & Investment News (the "News") describes the new definition of RHQ, establishment requirements, approval timeframe, business scope and benefits brought about by Circular 28 and suggests actions you may wish to take in order to better prepare yourselves before you make investment decision in Shanghai. You will also find in the News our analyses and insights we managed to learn from reliable sources.

Definition of RHQ

Pursuant to Circular 28, a company in Shanghai (hereinafter referred to as "SHCo") can be qualified as an RHQ if its foreign registered parent company empowers it to become the sole entity in the region to exercise overall management and services over other subsidiaries within the region. The empowerment can come in the form of equity holding in such subsidiaries or through an authorization.

(N.B. In practice, either the parent company or any company within the group are eligible to authorize the SHCo to exercise a management role on domestic or overseas subsidiaries without transferring the equity interests to the RHQ. The reason behind this practice is to avoid the prolonged approval process for a Chinese holding company to invest in overseas investees.)

The RHQ must be a legal entity and can be either a CHC or a management company. A CHC is a company established in accordance with the CHC regulations¹ which can directly invest in other entities; whereas a management company is a company solely for consolidated management, research and development (R&D), capital management, sales, logistics, supporting role services and other purposes.

Establishment requirements

For CHCs already established in Shanghai, they can directly apply for the RHQ recognition.

A management company has to fulfill the following requirements before it can apply for the RHQ status:

- ▶ The total assets of its parent company should be no less than US\$400 million
- ▶ The accumulated paid-up capital of investments in China by its parent company should be no less than US\$10 million and there are at least three subsidiaries (both inside and outside China) to be managed by the RHQ through an authorization from the parent company

(N.B. The requirement on accumulated paid-up capital of Chinese investment is reduced compared to the RHQ Tentative Measures issued in 2002.)

Alternatively, the total number of subsidiaries (both inside and outside China) authorized by the parent company should be no less than six

(N.B. The term "parent company" as used above appears to require the three or six subsidiaries to be held by one single holding company. However, given the complexity in cross border taxation and business regulations, investors in general do not prefer to hold both Chinese and non Chinese subsidiaries under the same holding company. Some investors may find it difficult to satisfy the above requirement of one parent company authorizing as many as three or six subsidiaries for the RHQ's management. If such difficulty does arise, the investor should discuss with the relevant approval authorities to see if subsidiaries owned by different holding companies in the same group may be acceptable.)

- ▶ For a management company, its registered capital should be no less than US\$2 million

Approval timeframe

Upon the receipt of all relevant application documents, the Shanghai Foreign Investment Commission (SFIC) shall complete the review and recognition procedures within 10 working days.

(N.B. The approval timeframe is cut from 30 days in the past to 10 days.)

[1] The CHC regulations have been revised a couple of times and the latest update on the CHC regulations was issued by the Ministry of Commerce on 26 May 2006.

RHQ's business scope

The following additional business activities are now permitted to be carried out by an RHQ:

- ▶ Domestic wholesale, import and export
- ▶ Logistics and distribution
- ▶ Shared services within the group and services out-sourced by overseas subsidiaries

(N.B. It remains uncertain whether existing RHQs in Shanghai can also carry out the above new functions. Company executives of existing RHQs should check with the SFIC on the possibility of expanding their business scope to benefit from the new regulation.)

An RHQ is allowed to establish branches within Shanghai to meet its operational needs.

Potential benefits

A newly established RHQ can be entitled to the following benefits:

- ▶ Subsidy for rental and establishment costs
- ▶ Certain rewards for the RHQ and/or its top management personnel
- ▶ Centralized capital management system
- ▶ Simplified immigration, employment and import/export procedures, priority in the application for Shanghai "hukou" (户口) for local elites

(N.B. The benefit scheme may include a one-off allowance given by the municipal government. We understand that the Shanghai municipal government is preparing a circular to be released later this year detailing the various benefits.)

Actions

More than six hundred foreign invested companies had landed Shanghai during the period from September 2002 until June 2008 in the nature of RHQs, CHCs and R&D facilities². Having gone through such a trial period, the Shanghai municipal government revised and formulated a new version of RHQ regulations apparently wishing to further secure Shanghai's position as one of the preferred location of choice for RHQs in Asia.

We understand that, despite the issuance of Circular 28, there are more procedural and explanatory circulars in the pipeline. Prior to the announcement of all details, MNC executives contemplating the establishment of RHQs in Shanghai should inquire with the SFIC, the district governments and relevant authorities to ensure that all available new benefits and subsidies have been granted to them. In case of doubt, companies should seek professional advice and services.

[2] Xinhua Net, Shanghai: New Regulations Encourage the Establishment of Regional Headquarters, 30 July 2008.

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