



Regulation for China Holding Companies Revised

The Ministry of Commerce just issued a Supplementary Regulation for Administration of Foreign Invested China Holding Companies (“CHCs”). Generally speaking, various operational restrictions have been relaxed. The Supplementary Regulation will be effective 1 July 2006. Below are the salient points:

Capital Injection Restrictions

- CHCs are currently required to inject their capital in full within two years after the issuance of business license. Going forward, they will be allowed to complete the capital injection process within five years after the issuance of business license provided that USD30 million is injected in the first two years. This relaxation is relevant to those CHCs which have registered capital exceeding USD30 million.
- Meanwhile, the Supplementary Regulation has clearly stated the requirement for necessary documentary proof for source of capital that a foreign investor needs to apply from the State Administration of Foreign Exchange (“SAFE”) when using legitimate RMB proceeds for making capital injection in CHC.
- When a CHC uses the RMB proceeds injected by the foreign investor to invest in setting up subsidiaries in China, there is no need to apply with SAFE again for documentary proof for the source of RMB funds given that such proof has already been obtained at the time of setting up the CHC.

Allowable Business Scope

- As an extension of the current outsourcing services for related enterprises, CHC will also be allowed to provide services to overseas unrelated parties.
- CHC is allowed to make strategic investments in domestically listed companies and will be treated as an overseas shareholder in a company limited by shares.
- Currently, CHC is allowed to import products from its parent company for trial sales and to source products from overseas to supplement existing self-made products for system integration purposes. The total value of importation is capped at the full amount of paid-up capital. Starting from 1 July, such importation will not be restricted to only those products sourced from the parent company. More importantly, the cap on importation will be removed.
- CHC can entrust domestic unrelated parties to produce or process its products or its parent company’s products for selling domestically or abroad according to the Supplementary Regulation with effect from 1 July. Such activity can only be performed by CHC with Regional Headquarters (“RHQ”) status under the existing regulation.
- Under the new regulation, CHC can incorporate commission agency services and wholesaling activity as its business scope upon establishment.

Regional Headquarters

- Unlike the current requirement, RHQ is no longer required to set up a finance leasing company to provide finance leasing business. RHQ will be able to provide operating leasing or finance leasing on its own account.
- RHQ will be allowed to act as a forex cash pooling centre upon approval by SAFE.
- A CHC with RHQ status can entrust domestic unrelated parties to produce or process products without restricting to those of its own or its parents'. Furthermore, it appears that a RHQ may even take up processing work if the products are for 100% export.

Is the Restriction on 2nd Tier Investment by Foreign Investment Enterprises Lifted?

Since 1 September 2000, the investment made by foreign investment enterprises (“FIEs”) within China have been under the constraint of Order # 6 from the Ministry of Foreign Trade and Economic Cooperation (which subsequently merged with the State Economic and Trade Commission and the State Development Planning Commission to form the current Ministry of Commerce). The Order states that 2nd tier investment by FIEs is restricted to the extent that the amount invested should not be more than 50% of net asset value of the investor FIE. This has imposed a significant constraint on foreign investors in structuring their investment in China.

With merit of the recently issued Gong Shang Wai Qi Zhi [2006] 102 (“Circular 102”) by the State Administration of Industry and Commerce, the 50% threshold above is effectively removed. Although Circular 102 does not provide for an effective date, one may interpret based on general practice that the issuance date of Circular 102, which is 26 May 2006, should be the effective date of this new practice.

In the context of this China Tax / Business News Flash, China refers to the People's Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

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