Cooperating with MNCs - new incentives in Shanghai to attract MNC regional headquarters

In brief

On 13 Aug 2019, the Shanghai Municipal Government issued the *Opinions on Promoting the Development of Regional Headquarters (RHQs) by Multinational Corporations (MNCs) in Shanghai* (Circular Hufugui [2019] No. 30, hereinafter the “Opinions”). The Opinions put forward 30 specific measures in the following four areas: enhancing efforts to encourage the establishment of RHQs in Shanghai, providing more convenience for MNCs to make investments, supporting free flow of funds and facilitating trade and logistics, so as to speed up the clustering of RHQs of MNCs in Shanghai. The Opinions will be effective from 1 September 2019 to 31 August 2024.

The Opinions relax the criteria for establishing RHQs and China holding companies, support free flow of funds, and provide policies regarding trading, research and development (R&D), logistics and supporting facilities of RHQs, in order to help MNCs deal with difficulties encountered in operation. The implementation of these policies will facilitate their business in China and may even develop into a new investment and operation model. For MNCs that have not yet entered China or are planning to do so, they can consider optimising their business arrangements by taking into account the new policies.

In detail

Because of its geographical advantage and inclusive and open investment environment, Shanghai is the Mainland city with most RHQs and foreign-funded R&D centres. According to the data disclosed at the News Conference held by Shanghai Municipal Government, Shanghai had cumulatively attracted 696 RHQs and 450 R&D centres as at the end of July 2019. Since 2019, relevant authorities of Shanghai has undertaken interview and survey, panel discussion, etc., to comb through problems existing in the development of RHQs in Shanghai and provide solutions to develop the headquarters economy in Shanghai. The Opinions put forward the following policies:

Relaxing the criteria for establishing RHQs

Before the release of the Opinions, the minimum total assets requirement of the parent company of a RHQ was USD 300 million, and there are also other requirements on total registered paid-in capital and the number of companies authorised to manage. These requirements are rather high for MNCs in emerging economies (e.g., Internet, service industry) which operate under light assets model. In addition, under the existing regulations, a RHQ must be a wholly foreign-owned enterprise ("WFOE"). However, with the development of China’s capital market, some MNCs may have plans for going public in China. If the RHQ is the listing vehicle, it would no longer be a WFOE and its RHQ status would be affected. In order to serve the needs arising from latest trend of development of MNCs and to attract RHQs from emerging economies, the Opinions relax the criteria for RHQs, more specifically:
• The minimum total assets requirement of the parent company of RHQs is reduced to USD 200 million and that for the parent company of Quasi-headquarters of MNCs is reduced to USD100 million;

• The RHQs requirements on registered paid-in capital and the number of companies authorised to manage were removed, and the requirement for Quasi-headquarters of MNCs on the number of companies invested by their parent company was also removed;

• The WFOE requirement for RHQs and Quasi-headquarters was also removed.

The above amendments are in the Regulations to Encourage the Establishment of Regional Headquarters by Multinational Corporations in Shanghai³ (Circular Huifu [2019] No. 31) which was released on the same day. In addition, it also stipulates that once a company is determined to be a RHQ, it can receive start-up subsidy, rental subsidy and other incentives in accordance with the relevant regulations. After the criteria for RHQs are relaxed, detailed implementation rules for subsidies and incentives need to be further clarified by the respective governmental authorities.

Facilitating RHQs to perform their functions

On one hand, the Opinions relax the criteria for RHQs to attract more RHQs to establish in Shanghai. On the other hand, the Opinions provides breakthroughs in investment facilitation, free flow of funds, convenience in trade and logistics, and R&D facilitation to support the six headquarters functions of investment, finance and treasury management, procurement and sales, R&D, human resource (HR) and logistics and distribution.

1) Relaxing the conditions for establishment of China holding companies (CHCs) by foreign investors

Foreign investors have always been interested in establishing CHCs to manage their investments in China, as CHCs are allowed to use foreign exchange capital for equity investments in China and can centralise the distribution of dividends from all subsidiaries in China. Before the release of the Opinions, foreign investors have to meet certain requirements to establish a CHC⁴. According to such requirements, a MNC that intends to establish a CHC in China should have set up or acquired at least one foreign-invested enterprise (FIE) in China and there is also a minimum paid-in capital requirement. If a MNC establishes a CHC for the purpose of managing all its investments in China, those investments have to be transferred to the CHC by way of corporate restructuring. This may result in additional tax burdens and uncertainties in practice.

The Opinions lower the minimum total assets requirement to USD 200 million and remove the requirements on registered paid-in capital and the number of companies invested in China by MNCs. This is good news for MNCs that have not entered into China or are planning to do so, as under the new policies, MNCs can establish the CHC first before actually investing or streamlining the investment structure so that additional tax burdens and practical uncertainties can be avoided.

2) Supporting free flow of funds

The Opinions put forward 13 measures to support free flow of funds, covering foreign exchange management, financial market, cross-border RMB business, etc., which include, centralised operation management under cross-border cash pooling, centralised receipt and payment of current account funds and net settlement business, centralised management of foreign debts (or offshore loans), management of domestic multi-currency master account under cash pooling, etc. These policies echo those set out in the Regulations on Centralised Operation and Management of Cross-border Funds of Multinational Corporations⁵ (Circular Huifa [2019] No. 7) released by the State Administration of Foreign Exchange. Under these new policies, once the cross-border cash pooling is filed for record with the relevant authorities, a RHQ can conduct centralised management of foreign debts and offshore loans for all of its member companies based on business need and following the macro-prudence principle. RHQs are no longer required to register for each individual foreign debt (or offshore loan) by currency or creditor/debtor. Such change will enhance treasury function of RHQs, which allows them to make full use of their domestic and foreign fund flows and centrally control foreign exchange risk. Meanwhile, these new policies may provide new solutions for historical issue such as unsettled long-term payable accounts.

Besides, the Opinions proposed to support foreign employees of RHQs to participate in the management of equity incentive funds for companies with A shares listed domestically. It can be expected that this policy will provide more flexibility for MNCs to list in the domestic capital market and is a booster for MNCs seeking for separate listing in Asian capital markets.

3) Supporting RHQs to undergo corporate restructuring

As some of the policies relating to the tax treatment of corporate restructuring by MNCs are unclear and may result in inconsistent administration in practice which would pose investment risk to MNCs. According to the Opinions, the Shanghai Municipal Tax Bureau and Shanghai Municipal Finance Bureau will be in-charge of providing facilitating measures for corporate restructuring involving RHQs. From the tax perspective, various policies regarding cross-border restructuring are not clearly defined. If, in the future, Shanghai can strengthen policy services regarding tax-related matters of corporate restructuring of RHQs in Shanghai such as assisting in coordination among regions and different tax categories, this would improve the certainty in tax treatment of corporate restructuring and increase the confidence of MNCs to invest in China.

4) Trial practice of “one business license with multiple addresses”

The Opinions propose to conduct a trial practice of “one business license with multiple addresses” for enterprises of RHQs operating under the chain store model throughout Shanghai, to provide more convenience for RHQs with prominent trading function establishing chain stores. Before the release of the Opinions, an enterprise of a RHQ operating under the China store model is required to obtain branch registration with the market regulatory authority if it is going to engage in business activities outside the legal address of the head office. However, this “one business license with multiple addresses” policy
allows an enterprise to register multiple business addresses under one business license, which significantly reduced the time to obtain business license. In addition, the Opinions emphasise that the policy is applicable throughout Shanghai; in other words, such enterprise of a RHQ is allowed to register the business addresses of all its stores in Shanghai under one business license, regardless of whether they are located in the same district.

Other remarkable measures in the Opinions include strengthening the auxiliary support to headquarters, such as providing exit-entry and residence permits for household service personnel employed by foreign executives, supporting the setting up of internationally known medical groups into Shanghai, facilitating foreign medical insurance settlement in China and encouraging more foreign quality schools to set up in China. Customs clearance and logistics facilitation measures include introducing the linking of self-serviced printing of the certificate of origin with credit rating, pilot programmes of customs bonded insurance, supporting eligible RHQs in cross-regional outsourced processing or transfer of deep processing transactions, exploring customs supervision measures such as implementing group guarantee and group credit measures, etc., so as to streamline registration, customs clearance, tax reduction or exemption and bonded business procedures for RHQs. R&D facilitation is mainly reflected in the import and export facilitation of experimental materials for R&D regional headquarters, lowering the number of employees requirement for start-up subsidy and rent subsidy available to foreign-funded R&D centres, and strengthening the administrative protection of foreign-related intellectual property (IP) rights to protect such IP rights of RHQs.

The takeaway

Following the issuance of the Overall Plan for the New Lingang Area of the China (Shanghai) Pilot Free Trade Zone, the Opinions was another heavy weight document issued by the Shanghai municipal government recently, which fully manifests Shanghai’s initiative of embracing the new dynamics of MNCs and international trade and investment. Different from other policies, the Opinions provide comprehensive facilitation and support in various aspects. Its focus moves from granting financial subsidies and incentives for RHQs to respecting the rules of the market, the future development of enterprises and improvement of the business environment.

It is worth noting that, in terms of upgrading the headquarters economy and headquarters functions and supporting the development of these functions, greater facilitation in the import and export of goods and a wider range of subsidies are offered to specific enterprises that perform certain high value-added functions (R&D, etc.), in addition to the stronger legal protection of IP rights.

It can be anticipated that the implementation of the Opinions will provide greater convenience for MNCs in business operation in China and may even develop into new investment and operation models. Especially for MNCs that have not yet entered into Chinese market or are planning to do so, they can tailor their business arrangements by taking into account the new policies, such as whether to set up a CHC before investing in China, and how to use the cross-border cash pooling effectively. Moreover, MNCs may also consider synergising with the preferential policies of the New Lingang Area to reasonably arrange their investments in Shanghai to make the most of these new incentives.

Endnote


2. Please refer to the appendix for the comparison of the criteria for the RHQs and Quasi-headquarters of MNCs before and after the implementation of the Opinions.


4. The application for the establishment of CHCs shall meet the following conditions:
   a) The foreign investor has good credit standing and has the necessary economic strength to hold a CHC. The total assets of the investor in the year before the application is not less than 400 million USD, and the investor has established a foreign-invested enterprise in China, and the paid-in capital of the registered capital is not less than 10 million USD, or b) The foreign investor has good credit standing and has the necessary economic strength to hold a CHC. The investor has established more than ten foreign-invested enterprises in China, and the paid-in capital of the registered capital is not less than 30 million USD.
   (In the condition of establishing a CHC by joint venture, the Chinese investor is of good credit and has the necessary economic strength to hold a CHC. The total assets of the investor is not less than RMB 100 million in the year before the application.

## Appendix:

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<tr>
<th>MNC regional headquarters</th>
<th>Quasi-headquarters</th>
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<td><strong>New criteria</strong></td>
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<td>(1) The enterprise must be a FIE with the status of independent legal person;</td>
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<td>(2) The parent company has total assets of not less than USD200 million;</td>
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<td>(4) The registered capital is not less than USD2 million;</td>
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<td>(5) If the enterprise basically meets the aforesaid conditions and makes outstanding contributions to the local economic development, the recognition may be discretionally.</td>
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<td>(2) The parent company has total assets of not less than USD400 million; where an enterprise in the service industry establishes RHQs, the parent company has total assets of not less than USD300 million;</td>
<td>(2) The parent company has total assets of not less than USD200 million, and has established not less than two FIEs in China, at least including one registered in Shanghai;</td>
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<td>(3) The total amount of registered capital which has been paid over time in China by the parent company is not less than USD10 million and the number of enterprises both inside and outside China, which the RHQ is authorized by the parent company to manage, is not less than six. If the enterprise basically meets the aforesaid conditions and makes outstanding contributions to the local economic development, the recognition may be discretionally;</td>
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Let’s talk

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