New policy direction for establishing regional headquarters in Shanghai by multinational corporations

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In brief

The Shanghai Municipal People’s Government issued the revised Regulations to Encourage the Establishment of Regional Headquarters (RHQ) by Multinational Corporations (MNCs) in Shanghai (Hufufa [2017] No.9, Circular 9) on 27 January 2017, to update the policy framework for encouraging MNCs to establish RHQ’s in Shanghai. Circular 9 relaxes the criteria for determining RHQ by expanding the scope to include Quasi-headquarters, removing the provision that China Holding Companies (CHCs) can be directly assessed as RHQs, abolishing the restrictions on RHQ’s business scope, and clarifying for the first time that governments at district level can, based on their specific circumstances, formulate their own measures to support RHQ’s development.

Shanghai has always been taking the leading role in China’s opening-up reform. It issued the provisional regulations to encourage MNCs to establish RHQs in Shanghai in 2002, turned it into the official regulations in 2008 and re-amended it by releasing the Regulations to Encourage MNCs to Establish RHQs in Shanghai (Hufufa [2011] No.98) in 2011. Relying on the series of incentive policies, headquarters economy has become a major driving force in promoting the economic growth in Shanghai. According to the relevant statistics, foreign investors have already set up 580 RHQs in Shanghai by the end of 2016, including: Asia Pacific headquarters, Asian headquarters and North Asia headquarters, etc. By the end of 2015, cumulative investment in RHQs have reached USD 45.7 billion with annual business revenue of 592.6 billion yuan and total taxes of 41.7 billion yuan, which contributed significantly to employment and tax collection in Shanghai. The release of Circular 9 is, on the one hand, to extend and improve the preferential policies provided to RHQs; and on the other hand, to implement the Notice of the State Council Regarding Measures on the Further Opening-up and the Use of Foreign Capital (Guofa [2017] No.5) so as to deepen China’s opening-up policy and improve the level of utilisation of foreign capital.

In this issue of News Flash, we will introduce the main content of Circular 9, analyse the new changes it has brought along, share our observations and look ahead to the follow-up policies.

In detail

Circular 9 amends the policy framework for encouraging MNCs to set up RHQs in Shanghai during the next five years and extends the preferential policies for fiscal incentives, fund management, entry-exit procedures for personnel, bringing in talents, custom clearance, etc. However, detailed implementation rules for incentive measures, such as the criteria for fiscal incentives and rent subsidy granted to RHQs upon their establishment and the supportive measures provided by the government at district level, remain to be further clarified by the respective governmental authorities. As an overall framework, Circular 9 has made the following major changes to the existing regulations:

- RHQ’s assessment criteria for the service sector are relaxed:
  The existing policy treats all Wholly-Foreign-Owned Enterprises (WFOEs) which apply for the RHQ status equally - their parent company’s total assets shall not be less than USD 400 million. Whereas Circular 9 lowers the threshold to USD 300 million for WFOEs engaging in the service sector, which is a favourable policy especially for those service companies with less tangible assets.
Inclusion of Quasi-headquarters: The concept of Quasi-headquarters is introduced in Circular 9, but this is not the first time that this concept is being mentioned. In fact, it was already touched upon in the supplementary regulations for RHQs back in 2014. Now Circular 9 reiterates that those WFOEs or branches that actually undertake the functions of regional strategic administration, fund management, procurement and sales, etc. cannot satisfy the RHQ’s assessment criteria. But they are still eligible under the revised status of RHQs and Quasi-headquarters. Moreover, Circular 9 also revises the assessment criteria for Quasi-headquarters by lowering the requirement on the number of entities established by quasi-headquarters in China (reduced from 3 to 2); while at the same time it increases the minimum registered capital (or operating capital) requirement for such enterprises (or branches) to not be less than USD 2 million.

It can be anticipated that Quasi-headquarters and RHQs would be subject to the same assessment process going forward. Moreover, the supportive policies to be released by governments at both the municipal and district level subsequently may provide different incentives to these two types of headquarters respectively.

CHCs’ direct recognition as RHQs is removed: It is noteworthy that Circular 9 removes the provision that CHCs can be directly recognised as RHQs without going through the general assessment process. Although the assessment criteria between CHCs and RHQs are quite similar, differences do exist. Going forward, CHCs have to apply for the RHQ status under the general standard and procedures and will be assessed similarly as other WFOEs. Meanwhile, in light of the differences in assessing CHC and RHQ, CHCs that are interested in applying for the RHQ status is recommended to be mindful of these changes and evaluate whether they are still eligible under the revised assessment criteria.

Restrictions on RHQ’s business scope is removed: Under the existing regulation, the business scope of RHQs is restricted to investment and management, fund management, research and development, products procurement, and personnel training, etc. Circular 9 has removed such restriction which means that RHQs can have more flexibility in determining the business activities they wish to conduct (e.g. manufacturing, trade, etc.) in order to align with the group’s overall strategy.

Governments at district level can formulate their own supportive policies: In order to further attract foreign investment, Guofa [2017] No.5 released earlier this year allows local-level government to formulate investment-friendly policies within their statutory authority to support projects that could greatly contribute to employment, economic growth and technological innovations, and reduce enterprises’ investment and operation cost. Against this backdrop, Circular 9 clarifies for the first time that governments at the district level have the discretion to formulate their own measures to support the development of RHQs and Quasi-headquarters. Foreign investors may have high expectation on RHQ supporting measures to be formulated at the local level, however, given that any fiscal and taxation incentives proposed by the local-level authorities have to be approved by the State Council from 2014, it remains to be seen what the local-level supporting measures will cover, for example, whether financial subsidies will be included. Meanwhile, it is worth waiting to see whether the local-level supporting measures will provide different level of support to different industries to reflect their local industry characteristics.

The takeaway
Circular 9 relaxes the RHQ’s applicable business scope and assessment criteria and incorporates the concept of Quasi-headquarters to attract more RHQs and functional institutions to come to Shanghai to participate in the development of the headquarters economy. This would further solidify Shanghai’s position as the most preferred location for setting up RHQ in China. Circular 9 took effect from 1 February 2017, qualified foreign invested enterprises may consider to lodge their RHQ application to the Shanghai Municipal Commission of Commerce who will be responsible for reviewing and assessing the application.

It is worth noting that the preferential policies under Circular 9 still needs to be further interpreted by the respective competent authorities, including the Commission of Commerce, Administration of Industry and Commerce, Finance Bureau, Tax Bureau, Foreign Affairs Bureau, Human Resources and Social Security Bureau, Exit-entry Inspection Bureau, Administration of Foreign Exchange, People’s Bank of China, Customs, and Entry-exit Inspection and Quarantine Bureau, etc. We believe that these interpretations and the supporting measures at the district level will be released soon. Before the release of those follow-up measures, enterprises are recommended to proactively communicate with the competent authorities to understand the trend of the relevant new policies.

With the release of Circular 9 in Shanghai, other central cities in the economic development zone including Beijing, Shenzhen, Tianjin and Guangzhou may release their own specific circulars to create a more open, convenient and transparent business environment and to actively respond to the State Council’s request to strengthen the work to attract foreign capital. Foreign-invested enterprises that are interested in applying for the RHQ status can also keep an eye on the development of the relevant policies in these other areas so as to facilitate their location study of where to establish an RHQ.

Endnote
1. For details, please refer to the Interpretation on the Regulations to Encourage the Establishment of RHQ by MNCs in Shanghai http://www.shanghai.gov.cn/nw2/nw2314/nw3124/nw18452/nw20020/u21aw1196337.html
2. For our analysis and observations on Guofa [2017] No.5, please refer to our News Flash [2017] Issue 3.
4. Notice Issued by the State Council Regarding the Cleaning-up and Standardization of Preferential Policies (Guofa [2014] No.62)
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