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New Shanghai Regulations Shoring Up Favored Location for Regional Headquarters

September 2008

On July 7, 2008, the People's Government of Shanghai Municipality promulgated a new set of *Rules for Encouraging Multinational Companies to Set-up Regional Headquarters* (the **"2008 RHQ Rules"**), replacing an old pack of regulations of the city back in 2002. The new 2008 RHQ Rules aim to prompt Shanghai as the favoured location for multinationals setting up regional headquarters ("**RHQs**"), in the wake of the national campaign of forging Shanghai as the incoming financial centre that is regaining momentum in the recent policy move.

This issue of **CHINA***journal* aims to highlight the new features of the 2008 RHQ Rules and assess its potentials for multinationals' restructuring or optimizing their China operations.

Foreign-invested Holding Company or Management Company

As having been analysed in **CHINA***journal* 2006 July issue, a RHQ in Shanghai can take either the form of a foreign-invested holding company under the national rule[1] or a management company specially provided in the Shanghai local regulation. It is confirmed in the 2008 RHQ Rules that an established foreign-invested holding company under the national rule may apply directly for the status as a RHQ in Shanghai. In addition, multinationals have the alternative to establish management companies in Shanghai to take up the role of RHQs.

The prerequisites for setting up a RHQ in the form of a management company is much less stringent than those of a foreign-invested holding company under the national rules. The management company should meet the following conditions:

- The total assets of the mother company is no less than USD 400 m;
- The total accumulated registered capital invested by mother company in China is no less than USD 10 m and the management company is to be authorized by the mother company to manage at least 3 subsidiaries in- and outside of China; or when not meeting the above-mentioned registered capital threshold, the management company is to be authorized by the mother company to manage at least 6 subsidiaries in- and outside of China;
- The registered capital of the management company is no less than USD 2 m.

The 2008 RHQ Rules have substantially lowered the investment requirements, compared with the 2002 Shanghai regulation, where it was required that the mother company should have at least USD 30 m accumulated investment in China and in the meantime the management company is to manage no less than 3 subsidiaries in and outside China. The 2008 RHQ Rules effectively make it possible for those multinationals that have not made substantial investment in China to establish RHQ in Shanghai, as long as such RHQ is to be used for managing at least 6 subsidiaries in and outside of China.

Extended Business Scope

The permitted business scope of a RHQ in Shanghai is extended to covering the following areas:

[1] *Supplementing Rules on the Establishment of Companies of an Investment Nature by Foreign Investors,* promulgated by the MOFCOM on May 26 and effective as of July 1, 2006.

- Domestic distribution and import and export;
- Merchandise distribution and other logistics operation;
- Providing intra-group shared services and taking up service outsourced by the overseas company.

in addition to those activities such as investment and operation decision-making, fund management and operation, R&D and technical support that have already been provided in the 2002 Rules. These newly included businesses in fact touch those areas that are only accorded to foreign-invested holding companies that are granted RHQ status under the national rule. Such RHQ status requires the satisfaction of very stringent prerequisites under the national rule. The 2008 RHQ Rules thus provide a much cheaper solution for multinationals to reshuffle and streamline their Chinese and regional alike operations.

Among others, the most useful functions that a Shanghai RHQ is able to carry out include:

Domestic Distribution

Chinese law treats distribution separate from im- /export. Ordinary FIEs are only permitted to import for own use and export for self-made products. Procurement, agent commission, wholesales, retails and franchising activities require special endorsement. As shown in **CHINA***journal* 2006 July Issue, a foreign-invested holding company is able to take on certain types of distribution functions, with limitation on the producer identity, exclusion of retailing, purpose of trade (trial sale or parts for maintenance) etc. The 2008 RHQ Rules have not set any such limitation on a RHQ in Shanghai. It is not clear whether this means a much cheaper Shanghai vehicle is actually able to do more than a higher profiled national holding company. The underlying tension and bargaining game between the central and local would cause uncertainty for the interpretation and implementation of the rules. Nevertheless, for those multinationals that cannot afford or are not willing to make much too high capital commitment as required by the national rules, the Shanghai RQH does provide a viable legal vehicle for the group's domestic distribution need, if not completely satisfactory.

Share Service

The services and activities entailed in a RHQ's business scope make it feasible to use such vehicle for a shared service centre. Typical shared services that a RHQ is eligible to carry out include R&D, HR, technical support and personnel training, after-sale service, market research, operating leases of machinery, transportation, warehousing, logistic and other general services.

Finance and Treasury Functions

The 2008 RHQ Rules retains the current solution for intergroup finance needs under the 2002 framework, which entails the entrustment loan facility, where a bank or trust company is involved as an intermediary between the lender and borrower. Also the pilot practices since October 2005, where RHQs in Pudong New District in Shanghai are allowed to provide forex currency daily cash concentration among the affiliates, are endorsed in the 2008 RHQ Rules. Also, surplus RMB balance may be converted into foreign currency and loaned to offshore companies subject to previous approval of Shanghai SAFE. Multinationals could also manage through an offshore account with a local bank the funds of overseas affiliate companies. Such pilot program enhances the ability of multinationals to effectively manage their international corporate treasury functions in China.

Government Support/Incentive and Personal Movement Facilitation

Under 2008 RHQ Rules, Shanghai government may provide finance support regarding the RHQ's office renting cost, subject to further detailed regulation. Also there are bonus or prize facilities for those RHQs and their leaders if their contribution to local economy is considered outstanding according to the city government.

Chinese staffs of RGQs will be provided with emigration facilitation regarding their business trips to Hong Kong, Macao, Taiwan and other regional headquarters. Foreign staffs, who need to stay in China for longer period, are eligible to apply for residence permit for a period of 3 -5 years.

Conclusion

The 2008 RHQ Rules in many aspects promote the RHQ in Shanghai as a cheaper legal vehicle which can do the same or even more than a national holding company. The newly inserted government finance support and personal cross-border movement facilitation place Shanghai's RHQ rules at equal footing with those of other competing cities such as Suzhou, Guangzhou, Nanjing and Beijing, which have their own rules to attract RHQs. Multinationals may wish to have a thorough analysis on how a Shanghai RHQ stands out and serves better for the purpose of regrouping the corporate structure and streamlining the business operation in China as well as the neighbouring region.

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