

Tax Analysis.

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PRC Tax

Beijing Introduces Rules to Encourage Multinational Corporations to Establish Regional Headquarters

On 29 June 2009, the Beijing municipal government issued implementing regulations ("New Regulations") that set out detailed and specific policies to attract multinational companies to establish regional headquarters (RHQs) in Beijing and to promote regional economic development. Specifically, the New Regulations:

- Lower RHQ recognition criteria and expand the types of enterprises entitled to RHQ status;
- Abolish income tax incentives and introduce cash subsidies and rewards; and
- Provide more preferential policies for RHQs established by multinationals.

The government had issued updated general rules on RHQs on 21 May 2009.

Beijing first issued rules promoting RHQs in 1999 ("Old Regulations"), which offered an array of significant benefits and incentives, including tax, foreign exchange control, market entrance, human resources, and expatriate working and living assistance benefits. To date, 121 foreign-invested holding companies have been set up in Beijing to function as RHQs, 41 of which have been approved by the Ministry of Commerce. The economic development capacity of these RHQs has ranked top among the 35 major cities in China for four consecutive years.

The Old Regulations, which are now 10 years old, no longer meet economic development needs, so the New Regulations adjust the relevant policies to adapt to the current economic situation and bolster efforts to support the establishment of RHQs in Beijing.

The following highlights the main changes made by the New Regulations:

RHQ recognition criteria and qualifying enterprises

The Old Regulations lacked clear criteria for the recognition of RHQ status, and in practice, the criteria in the Ministry of Commerce's "Provisions on the Establishment of Investment Companies by Foreign Investors" generally were used to determine RHQ status. Thus, under the Old Regulations, only foreign-invested holding companies could be recognized as RHQs and the recognition standards were high. The New Regulations clarify that both foreign-invested management companies and foreign-invested holding companies may be recognized as RHQs. A foreign-invested management company is a "business legal person that is established to provide management, decision-making, research and development, capital management, logistics, sales, planning, consulting and training services to companies invested by the parent company and other related companies." To qualify as an RHQ, a foreign-invested management company must meet the following criteria:

- The total assets of the parent company may not be less than USD 400 million;
- The aggregate contributed capital by the parent company in China may not be less than USD 10 million and the parent company must invest (or authorize the management company to manage) at least three domestic or overseas companies; alternatively, the parent company must invest (or authorize the management company to manage) at least six domestic or overseas companies;
- The registered capital of the foreign-invested management company may not be less than USD 2 million; and
- The foreign-invested management company must be the sole top operating and management body of the parent company in China.

These conditions may be relaxed for well-known multinational companies.

Abolition of income tax incentives and introduction of cash subsidies and rewards

The New Regulations abolish the tax rebate for reinvestment, the rebate on the portion of income tax allocated to the local government and the exemption from local income tax under the Old Regulations and replace them with preferential policies that include subsidies and rewards for qualified RHQs and individuals. These changes are designed to encourage large-scale RHQs that have a significant impact on the regional economy.

Subsidized Items	Criteria to Obtain Subsidy	Subsidy	Payment Method
Capital Subsidies	RHQs that are newly registered in or that relocate to Beijing on or after 1 January 2009 may apply for a one-time cash subsidy depending on the amount of registered capital:		Installment payments in three years at a rate of 40%, 30% and 30% of the subsidy amount
	- Registered capital between RMB 100 million and RMB 500 million	RMB 5 million	
	- Registered capital between RMB 500 million and RMB 1 billion	RMB 8 million	
	- Registered capital of at least RMB 1 billion	RMB 10 million	
	RHQs that reached the above thresholds through a one-time capital increase will be granted subsidies according to the incremental increase, but the cumulative subsidies may not exceed RMB 10 million		

Subsidized Items	Criteria to Obtain Subsidy	Subsidy	Payment Method
Subsidies for Office Rentals, Purchases and Construction	RHQs that are newly registered in or that relocate to Beijing will be granted a rental subsidy if the lease term exceeds three years. The subsidy will be recaptured, however, if the office is subleased or altered for another use within the period in which subsidies are granted.	<ul style="list-style-type: none"> - 30% of the first year's rent - 20% of the second year's rent - 10% of the third year's rent <p>The largest space that qualifies for a subsidy may not exceed 3,000 square meters.</p>	Annual payment
	An RHQ may apply for a one-time subsidy for self-constructed and purchased offices for the RHQ and research centres that are registered in or that relocate to Beijing on or after 1 January 2009. The subsidy will be recaptured if the office is sold, leased or used for another purpose within five years.	RMB 1,000 per square meter as a subsidy for self-used office space up to 5,000 square meters	Annual payment
Rewards for promoting economic development	<p>From 2009, RHQs with annual revenue exceeding RMB 100 million <i>for the first time</i> may apply for a reward as follows:</p> <p>Annual revenue reaches between RMB 100 million and RMB 500 million <i>for the first time</i></p> <p>Annual revenue reaches between RMB 500 million and RMB 1 billion <i>for the first time</i></p> <p>Annual revenue reaches RMB 1 billion <i>for the first time</i></p>	<p>RMB 1 million as a one-time reward</p> <p>RMB 5 million as a one-time reward</p> <p>RMB 10 million as a one-time reward</p> <p>Cumulative subsidies may not exceed RMB 10 million</p>	Installment payments in three years at a rate of 40%, 30% and 30% of the reward amount

The reward granted to individuals at RHQs includes:

Individual	Reward	Payment of Reward
One chief executive	80% of the individual income tax retained by the local government from the executive in one year (not exceeding RMB 500,000). The reward will be granted for three years following the year RHQ status is recognized.	Annual single payment
One chief executive of an RHQ whose annual enterprise income tax increment is ranked in the top 10 (only the enterprise income tax retained by the municipal government is taken into account)	RMB 500,000	Annual single payment

In addition, persons whose positions are vice general manager or above for more than two consecutive years will be rewarded in accordance with the Beijing "Municipal Regulations on rewards for attracting high-level talent".

Other preferential policies

In addition to the above, eligible RHQs will be entitled to the following benefits:

- Relief in respect of foreign exchange control, customs clearance, etc.
- Simplified government formalities and a clarified approval time line
 - a) The Beijing Municipal Commission of Commerce, which is responsible for the approval of RHQs, must complete the approval procedure within 10 working days after submission of completed documents by the company;
 - b) Companies that qualify for subsidies or rewards must submit an application and other relevant documents to the district level Commission of Commerce between 1 August and 30 September each year. After a preliminary examination by the authorities and approval of the district government, the application will be submitted to the Municipal Commission of Commerce before 31 October to re-examine the package in conjunction with the Development and Reform Commission, finance, taxation, statistics and other departments, and report to the municipal government for final approval.
- The general applicability of the policy for the entry and exit of expatriates will be eased.
- Expatriate employees will receive assistance in purchasing a residence in China.

Tax implications and comments

The introduction of the New Regulations will have beneficial effect on multinationals establishing RHQs in Beijing. However, multinational corporations should pay attention to the following:

- **Taxability of subsidies and rewards:** The New Regulations do not clarify the enterprise income tax treatment of subsidies and rewards received by RHQs.
- **Establishments:** RHQs usually engage in marketing, information collection and project engagement, etc. functions. If an RHQ signs contracts, or stores or delivers goods on behalf of a foreign company, the foreign company is likely to create an establishment in China and, therefore, income attributed to the establishment will be subject to Chinese enterprise income tax. Action should be considered to manage any related tax exposure.
- **Chinese resident company status:** It is possible that an RHQ's management functions for a foreign company may cause the "effective management or control" of the foreign company to be located in China, with the result that the foreign company could be regarded as resident for Chinese tax purposes and therefore subject to Chinese tax on its worldwide income. Foreign investors should evaluate the criteria for determining the place of effective management and control, together with the operation of the group, and to take any measures necessary to mitigate such tax risks.
- **Related party transactions:** The Chinese tax authorities may make tax adjustments based on reasonable methods if intragroup services are not priced on an arm's length basis. Therefore, services provided by an RHQ to its related companies should be charged on arm's length terms and service contracts signed between an RHQ and its related parties should clearly define the service content, the charging standard and fee amount. In addition, if related party transactions meet certain thresholds, the RHQ should prepare contemporaneous documentation to support the pricing policy and control any transfer pricing adjustment exposure.

It should also be noted that some of the implementing measures of the New Regulations need to be clarified, such as:

- The New Regulations indicate that the subsidies/rewards will be issued “in three years.” Does this mean that RHQs should not relocate for at least three years or the subsidies granted will be recaptured?
- Do RHQs engaged in pilot operations, such as centralized management of foreign exchange funds and offshore lending need to comply with additional requirements to operate these businesses?

The Deloitte professional services team will closely monitor and provide updates on any new developments in this area and would be happy to provide you with further analysis and planning on the tax implications of the New Regulations. If you need technical support or further information, please feel free to contact one of our tax professionals.

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