

CHINA TAX ALERT

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China (Shanghai) Pilot Free Trade Zone is officially launched

Regulations discussed in this issue:

- *The Overall plan for China (Shanghai) Pilot Free Trade Zone (State Council Announcement 2013 No. 38, issued on 18 September 2013)*

Background

The China (Shanghai) Pilot Free Trade Zone was officially launched on 29 September, 2013. The State Council recently released the overall plan for the China (Shanghai) Pilot Free Trade Zone, which sets out the blueprint of the Zone's key underlying principles - improve investment facilitations to meet international standards; deregulation of currency exchange controls; and improve efficiency and flexibility in terms of government regulatory controls and legal environment specification within the next two to three years after these reforms.

The establishment of the China (Shanghai) Pilot Free Trade Zone is no doubt a significant milestone for China's economy transformation and we expect this to be only the first of many new reforms to come in the near future. Given the interest from both domestic and internal investors, we will keep you updated regarding the latest reforms, hot topics, insights and opportunities introduced as part the Free Trade Zone's overall plan.

Development history of the China (Shanghai) Pilot Free Trade Zone

3 July, 2013	The State Council executive meeting passed 'The Overall Plan for China (Shanghai) Pilot Free Trade Zone' in principle.
22 August, 2013	The State Council officially approved to establish the China (Shanghai) Pilot Free Trade Zone, which is composed of four areas with special supervision of the Customs including the Waigaoqiao free trade zone, the Waigaoqiao bonded logistics park, the Yangshan bonded port, and the Shanghai Pudong airport comprehensive bonded zone.
30 August, 2013	The Standing Committee of the National People's Congress released 'Decision on authorising the State Council to temporarily adjust the administrative examination and

	approval items prescribed in the relevant laws within Shanghai Free Trade Zone', which eliminates the investment pre-approval requirement and adopts filing system.
27 September, 2013	The State Council released the notice of 'The Overall plan for China (Shanghai) Pilot Free Trade Zone'. The overall goals are: 1. Accelerate transformation of government functions; 2. Innovation in the investment management model; and 3. trade and investment facilitation.
29 September, 2013	Official establishment of the China (Shanghai) Pilot Free Trade Zone. The relevant 98 detailed regulations will be released in due course.

Framework overview

1. Main tasks and measures

1) Accelerate transformation of government functions

- To reform the current government management system and build up an administrative management mechanism in line with the international standards on investment and trade
- To shift from current pre-approval mechanisms to post-supervision mechanisms, and build up efficient government service operations
- To increase and improve government administration transparency and information disclosure mechanisms in order to meet international standards

2) Opening up new investment opportunities

- To further expand certain industries for investment, including financial services, shipping services, commercial trading services, professional services, cultural services, and other social services
- To suspend or eliminate restrictions on investment in certain areas in terms of the qualification requirements, equity holding limits, business scope limitations and other access restrictions
- To relax certain restrictions on foreign investors, e.g., to grant foreign investors national treatment, to formulate negative list management model ('exclusion list'), and to replace pre-approval with filing management for the areas outside of the exclusion list
- To adopt filing/recordal management system for establishing enterprise abroad or outbound investment in order to increase convenience for outbound investment; in addition, to encourage the establishment of Special Purpose Vehicles (SPV) specialising in overseas equity investment and establishment of parent funds conducting overseas equity investment.

3) To accelerate transformation of trading

- To encourage multinational companies to set up their Asia-Pacific headquarters and operation centres; to further develop international trading settlement centres; to support companies in the zone to promote their offshore business
- To explore a platform for large-sum international commodities trading and resource configuration for international merchandise trade, while at the same, to extend and improve the pilot on futures and bonded delivery and to expand functions such as warehouse receipt financing

- To promote various outsourcing services; to encourage various finance leasing companies to set up SPVs to conduct onshore and offshore leasing business; to encourage establishment of third party inspection institutions; to pilot cross-border high value-added and high tech maintenance service and to promote cross-border e-business services
- To upgrade the international shipping services and develop the joint effect of the Waigaoqiao port, the Yangshan port, and the international hub - Pudong airport; to develop shipping finance, international shipping, international vessel management and brokerage.

4) To open up financial services sector through innovation

- To promote RMB capital account convertibility, financial market interest rate liberalisation, cross-border use of RMB on the condition that any risks remains manageable; to allow financial asset pricing to be determined by financial institutions within the Zone
- To reform foreign debt administration to facilitate investment, trade and cross-border financing, and to encourage multinational companies to set up regional or international fund management centres
- To open up financial services to private and foreign capital; to encourage the establishment of foreign-funded banks or Sino-foreign joint venture banks; to allow foreign enterprises to gradually participate in commodity futures transactions; to support equity trust trading institutions to set up a platform for comprehensive financial services; to support RMB cross-border reinsurance business.

5) To improve the current legal framework

- To align the regulations from 'Law of the PRC on Wholly Foreign-owned Enterprises', 'Laws of the PRC on Sino-foreign Equity Joint Ventures', and 'Law of the PRC on Sino-foreign Cooperative Enterprises' regarding the administrative pre-approval procedures in order to support the development of the Free Trade Zone
- To set up management policies that matches the pilot requirements for the pilot zone by Shanghai municipal legislation.

2. Supervision and tax policies

- To simplify entry and exit record lists and the declaration formalities for international transit, less container load and distribution; to have import inspection while loosening outbound inspection; to build the supervision mode of classification of cargo status; to set up an exhibition and trade platforms for bonded goods; to strengthen the electronic information network, and to set up the inspection and quarantine supervision mode for convenient entry and exit and quality risk prevention
- To introduce favourable tax measures to promote investment and trade, especially tax deferral payment by via installment on income derived from asset valuation appreciation and individual income derived from stock-based incentive compensation; export tax rebates for financial leasing companies; if domestic leasing companies or their SPVs purchase aircrafts with net weight of 25 tonnes or above from offshore and in turn lease such aircrafts to domestic airlines, they may enjoy reduced import value added tax; to complete tax policies for overseas equity investment and offshore business development.

KPMG observations

With the public announcement of the Overall Plan of China (Shanghai) Pilot Free Trade Zone by the State Council of the PRC and the official launch, the overall direction and goals of the China (Shanghai) Pilot Free Trade Zone have now been established. Detailed regulations and guidelines following the Overall Plan are still to be observed especially with respect to the practical implementation issues going forward.

Based on the current Overall Plan of the China (Shanghai) Pilot Free Trade Zone, we note the following:

- Financial sector related reform is one of the key highlights in the Overall Plan of China (Shanghai) Pilot Free Trade Zone. It is expected that further reforms will take place to promote the convertibility of the RMBi, the cross-border use of the RMBand interest rate liberalisation. Once the implementation details are released, we foresee that financial institutions will develop innovative financial services and products to allow China to be even more compentitve on an international basis; foreign and private capitals can explore the opportunities in market entry of financial services; enterprises need to review and restructure their treasury management policies accordingly.
- While the exclusion list noted above is yet to released, we expect that once this is released, it will provide clearer directions to foreign investors with respect to market entry requirements. Industries eligible for the national treatment will be expecting authorities involved to effectively simplify the administrative procedures and to provide greater convenience for investors once the filing mechanism is implemented.
- Detailed implementation rules concerning the relaxation of the restrictions in the six major services industries remain to be seen in terms of the expected timeline, specific requirement towards investors, forms of investment, permitted business models, and limitations on client base and servicing areas.
- Although tax reforms do not appear to be the key drivers under the current Overall Plan, we expect that the government may potentially develop preferential policies towards promoted industries through local subsidies in order to increase their competitiveness at home and abroad.
- Breakthrough reforms are required in terms of foreign exchange control under the proposed trade remodelling and financial reform. We expect that foreign exchange policies applied in the China (Shanghai) Pilot Free Trade Zone will be released in due course.
- To effectively simplify the customs supervisions, inspection and quarantine measures play a critical role in promoting cross-border and cross-zone trade. It will be interesting to see how this could be achieved once the related regulations are released.

Appendix: Service sectors to be opened

Financial Services

1. Banking	<ul style="list-style-type: none">Qualified foreign investors will be allowed to set up foreign-owned and Sino-foreign joint venture banks and limited licence banksQualified Chinese banks will be allowed to conduct offshore business
2. Healthcare insurance	<ul style="list-style-type: none">Foreign-owned healthcare insurance companies will be allowed
3. Finance lease	<ul style="list-style-type: none">Minimum registered capital limitation for SPVs will be removedFinance lease companies will be allowed to be engaged in factoring related to its primary business

Shipping Services

1. Shipping	<ul style="list-style-type: none">Foreign shareholding limitation in cargo shipping joint ventures will be relaxedForeign ships owned or controlled by domestic companies are allowed to take coastal shipping business between Shanghai Port and other domestic ports
2. International ship management	<ul style="list-style-type: none">Wholly foreign-owned shipping management companies will be allowed

Trade Services

1. Value-added telecommunication	<ul style="list-style-type: none">Qualified foreign companies are allowed to conduct value-added telecommunication services in specific forms
2. Entertainment and game machines	<ul style="list-style-type: none">Foreign companies are allowed to manufacture and sell entertainment and game machines

Professional Services

1. Law firms	<ul style="list-style-type: none">To explore mechanisms of the business cooperation between Chinese law firms and overseas (including Hong Kong, Macau, Taiwan) law firms
2. Credit investigation	<ul style="list-style-type: none">Foreign-invested credit investigation companies will be allowed
3. Travel agency	<ul style="list-style-type: none">Qualified Sino-foreign travel agencies are allowed to conduct overseas travel business (except Taiwan)
4. Human resource agency	<ul style="list-style-type: none">Foreign shareholding limitation will be relaxed. Minimum registered capital of Sino-foreign or wholly foreign owned human resource agency will be lowered
5. Investment management company	<ul style="list-style-type: none">Foreign holding companies will be allowed
6. Engineering design	<ul style="list-style-type: none">Establishment requirement for engineering design companies which provides service in the China (Shanghai) Pilot Free Trade Zone are relaxed
7. Construction service	<ul style="list-style-type: none">Wholly foreign-owned construction enterprises in the China (Shanghai) Pilot Free Trade Zone will be allowed to conduct Sino-foreign joint construction projects in Shanghai regardless of the portion of foreign participation

Culture Services

1. Performing agencies	<ul style="list-style-type: none">Wholly foreign-owned performing agencies are allowed to provide services in Shanghai
2. Entertainment venues	<ul style="list-style-type: none">Wholly foreign-owned entertainment venues are allowed to provide services in the China (Shanghai) Pilot Free Trade Zone

Public Sector Services

1. Educational Training and Professional Skills Training	<ul style="list-style-type: none">Educational training and professional skills training institutions can be established as Sino-foreign joint ventures
2. Medical Services	<ul style="list-style-type: none">Wholly foreign owned medical institutions are allowed to be established

Attention: The above standards only apply to the companies registered in the China (Shanghai) Pilot Free Trade Zone.

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