

CHINA TAX ALERT

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Pilot Free Trade Zone Series — Administrative regulation and other supporting rules for China (Shanghai) Pilot Free Trade Zone

Regulations discussed in this issue:

- *Administrative Regulation for China (Shanghai) Pilot FTZ* (Announcement No.7 issued by Shanghai Municipal Government on 29 September 2013)
- *Special Administration Rules for Foreign Investments in China (Shanghai) Pilot FTZ relating to the Negative/Exclusion list* (Hufufa [2013] No.75, issued on 29 September 2013)
- *Filing Administrative Rules for Foreign Investment Projects in China (Shanghai) Pilot FTZ* (Hufufa [2013] No.71, issued on 29 September 2013)
- *Filing Administrative Rules for Foreign Investment Projects in China (Shanghai) Pilot FTZ* (Hufufa [2013] No.72, issued on 29 September 2013)
- *Filing Administrative Rules for Foreign Investment Projects in China (Shanghai) Pilot FTZ* (Hufufa [2013] No.73, issued on 29 September 2013)
- *Filing Administrative Rules for Foreign Investment Projects in China (Shanghai) Pilot FTZ* (Hufufa [2013] No.74, issued on 29 September 2013)

Background

On 29 September 2013, the Shanghai Municipal Government released the first series of policy documents regarding the China (Shanghai) Pilot Free Trade Zone (“the Pilot FTZ”), including Administrative Regulation for China (Shanghai) Pilot FTZ (the “Administrative Regulation”) and Special Administration Rules for Foreign Investments in China (Shanghai) Pilot FTZ relating to the Negative/Exclusion list (the “Negative List”), as well as four Filing Administrative Rules aimed at promoting foreign investment management system reform (the “Filing Administrative Rules”).

Overview of the Administrative Regulation

Pursuant to the Overall Plan for China (Shanghai) Pilot FTZ published by the State Council (please refer to [China Tax Alert Issue 26](#)), the Shanghai Municipal Government stipulated the Administrative Regulation. As the general instruction document for the development of the Pilot FTZ, the Administrative Regulation elaborates on the administrative rules of the Pilot FTZ in terms of the following aspects:

Administration organisation	<ul style="list-style-type: none"> • The Administrative Regulation stipulates that the Administration Committee of the China (Shanghai) Pilot FTZ (the “Administration Committee”) is responsible for managing and coordinating the administrative affairs of the Pilot FTZ. Specifically, the Administration Committee will be in charge of administrative management for investment, trade, financial services and construction within the Pilot FTZ.
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Investment management	<ul style="list-style-type: none"> • Based on the Overall Plan, the Administrative Regulation emphasises the importance of opening up to particular industries, including financial services, shipping services, commercial trading services, professional services, cultural services and other social services, and supporting the suspension or elimination of restrictions on the qualification requirements for investors, equity holding limits, business scope limitations and other access restrictions. • It also specifies the granting of national treatment to foreign investors, the implementation of the “negative list” management model to promote foreign investment, and the adoption of a filing management model for overseas investment. • In addition, it stipulates that registration of paid-in capital should be implemented in the Pilot FTZ, i.e., except for certain special enterprises, investors can decide the amount of paid-in capital, the contribution methods and the contribution timeframe.
Trade development and facilitation	<ul style="list-style-type: none"> • The Administrative Regulation proposes the development of various new-type trade models in order to promote/upgrade trading business, strengthen the functional ability of the shipping centre, and promote trade development through various supervisory regimes for entry/exit facilitation services.
Finance innovation and risk prevention	<ul style="list-style-type: none"> • The Administrative Regulation provides policy guidelines for development and management of financial business in the Pilot FTZ from the perspectives of financial innovation, capital account convertibility, interest rate liberalisation, RMB cross-border usage, foreign exchange management, financial body development, and risk prevention.
Overall management and service	<ul style="list-style-type: none"> • According to the Administrative Regulation, the Pilot FTZ will establish an efficient and convenient management and service model that meets international requirements and relevant legislative standards in order to facilitate investment and trade. For example, a “one-form declaration, one-desk processing” working mechanism for managing foreign investment and overseas investment will be established to improve management efficiency. • The Administrative Regulation also provides high-level rules regarding management information disclosure, supervision improvements, safety checks, anti-monopoly investigations, protection of intellectual property rights, annual corporate public reporting, credit information systems, supervision information sharing systems, comprehensive assessment mechanisms, administrative reviews, and commercial dispute resolution related issues in the Pilot FTZ.

It is worth noting the specific responsibilities of the Administration Committee listed in the appendix to the Administrative Regulation, which include administrative examinations and approvals, administering penalties, etc.

Issuance of Negative (Exclusive) List and its main contents

In order to achieve the objective of “national treatment for foreign investment” and the “negative list management model”, the Shanghai Municipal Government has formulated the Negative List (2013 version) based on the Overall Plan, 《Catalogue of Industries for Guiding Foreign Investment (2011 Revision)》 (“The Catalogue”) and other regulations. The Negative List covers 18 industries and lists the non-national entrance procedures imposed on foreign investment in the Pilot FTZ. The non-national entrance procedures include various administration measures, such as restrictions on registered capital, equity ratio and business scope, as well as business performance requirements.

One of the main highlights of the Negative List is the replacement of the pre-approving mechanism, with the filing mechanism now applicable to foreign investments in areas beyond the Negative List (the exceptions for certain investments are still governed by the State Council), which provides greater convenience for foreign investments in the Pilot FTZ.

This Negative List retains the most restricted and prohibited areas listed in the Catalogue, which contains some important areas in terms of attracting special attention from the government and public. This includes finance, real estate, education, and information and cultural communication.

In addition, as mentioned in the Overall Plan, the scope of opening-up will be expanded for several service industries will. The 2013 Negative List also lists special administration measures applicable to investment categories as follows:

Investment Category	Special administration measures according to Negative List
Financial Services	<ul style="list-style-type: none"> • The activities of investment banks, finance companies, trust companies and money brokerage companies are restricted • Investment in insurance companies (the proportion of foreign investment shall not exceed 50 percent), insurance intermediary institutions, and insurance asset management companies is restricted • The proportion of foreign investment in areas such as securities companies, securities investment and fund management companies must not exceed 49 percent • Investment in financing lease companies must meet the relevant requirements on the total assets of the foreign investors, registered capital of the company, professional qualifications of senior management,

	and industry experience.
Shipping Services	<ul style="list-style-type: none"> • Investment in international ocean shipping cargo handling and the international ocean shipping container station and yard business is restricted to equity joint ventures or contractual joint ventures • Investment in shipping agents is restricted (with Chinese parties acting as controlling shareholders) • Investment in ocean shipping is restricted (limited to equity joint ventures or contractual joint ventures).
Trade Services	<ul style="list-style-type: none"> • Investment in telecommunications, broadcasting and TV transmission and satellite services is restricted • The proportion of foreign investment in other information services must not exceed 50 percent • The proportion of foreign investment in the domestic internet virtual private network business must not exceed 50 percent • The proportion of foreign investment in the operational electronic business must not exceed 55 percent and the proportion of foreign investment in other online data processing and transaction processing business must not exceed 50 percent.
Professional Services	<ul style="list-style-type: none"> • Investment in accounting firms is restricted to partnerships • Except for Hong Kong and Macau, foreign investors from other regions may only set up equity joint-venture HR agencies, and the proportion of foreign investment must not exceed 70 percent • The minimum registered capital requirement for HR agencies is USD125,000, and foreign investors must be foreign companies or other organisations who have been engaged in HR services for more than three years • Investment in legal consulting is restricted • Foreign law firms may only provide legal services by setting up representative offices • Investment in overseas travel business is restricted to equity joint-venture travel agencies (travel agency services to Taiwan are prohibited) • Investment in rating service companies is restricted

	<ul style="list-style-type: none"> • Relevant requirements regarding total assets of foreign investors, domestic investments of foreign investors, and registered capital of the investment company must be met when setting up a China Holding Company.
Culture Services	<ul style="list-style-type: none"> • Investment in construction and operation of cinemas is restricted (with Chinese parties acting as controlling shareholders) • Investment in construction and operation of large theme parks is restricted • Investment in construction and operation of golf courses is prohibited • Investment in internet access service sites (internet bars) is prohibited • The gambling and lottery industry is prohibited • The pornography industry is prohibited.
Social Services	<ul style="list-style-type: none"> • Investment in operational educational training institutions and vocational skills training institutions is restricted to contractual joint ventures • Total investment in medical institutions must not be less than RMB 20,000,000, and the operational period shall not exceed 20 years; establishment of branches is not allowed.

Scope of application of the Filing Administrative Rules and important notes

The Filing Administrative Rules comprises four detailed filing administrative rules designed to promote reform of the system used for managing investments in the Pilot FTZ and overseas investments, effective from 1 October 2013.

i. Scope of application:

	Investment in FTZ	Overseas Investment
Project Investment	Foreign-invested projects not in the Negative List (Note 1)	Normal overseas investments by the companies in the Pilot FTZ (Note 3)
Company Establishment	Foreign-invested companies not in the Negative List (Note 2)	Establishment of overseas entities by the companies in the Pilot FTZ (Note 4)

Note 1: Including Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, wholly foreign-owned enterprises, foreign-invested partnerships, mergers and acquisitions of domestic enterprises by foreign investors, capital increase of foreign-invested enterprises and other foreign investment projects.

Note 2: Including the establishment and alteration of foreign-invested companies in the Pilot FTZ, and foreign-invested companies newly established in the Pilot FTZ, which are also not included in the Negative List.

Note 3: Investment in sensitive countries (regions) or investment in sensitive industries shall require approval from the National Development and Reform Commission or the State Council.

Note 4: Specific-type overseas investments which are involved in the interest of specific countries (regions) or multinationals (regions) shall still be implemented in accordance with "Administrative Measures on Overseas Investment".

ii. Important notes for filing records

	Projects in Pilot FTZ	Companies in Pilot FTZ	Overseas Projects	Overseas Companies
Filing Authority	Administration Committee	Administration Committee	Administration Committee	Administration Committee
Filing Method	Documents submission	Online reporting	Documents submission	Documents submission
Filing Deadline	Within 10 working days	Within 1 working day	Within 5 working days	Within 5 working days
Validity of Filing	2 years	Within 30 days	2 years	2 years
Alteration of Filing	Required	Required	Required	Required
Related Certificate	Opinions of project filing	Filing certificate of invested company	Opinions of project filing	Overseas investment certificate

KPMG observations

The launch of the Administrative Regulation and other relevant rules offers us an opportunity to gain a greater understanding on the future development of the Pilot FTZ. Although the detailed policies require further elaboration, we believe that investors should pay close attention to the following aspects based on the first series of policies released to date:

- The first-released **Negative List** covers 18 industries, 89 investment categories and 190 specific administrative measures for foreign investments. We note that the Negative List almost matches the current categories for restricted and prohibited projects in the Catalogue of Industries for Guiding Foreign Investment, which have no relaxed rules on such projects for foreign investors. Such an arrangement reflects the Shanghai Municipal Government's determination to maintain appropriate risk control in the event that the zone develops too quickly. However, together with the further development and actual commercial requirements of the Pilot FTZ, we anticipate that the Negative List may be adjusted in the future, where necessary.
- Under the "**Management Model of the Negative List**", foreign-invested projects and establishments of foreign-invested companies which are not included in the list will be monitored under the filing record mechanism instead of the previous pre-

approval mechanism. In our view, the reform simplifies administrative procedures. Meanwhile, investors should pay attention to the relaxation of restrictions on the amount of paid-in capital, contribution methods and contribution timelines that has resulted from the paid-in registered capital registration system, as well as its influence on their future investment plans.

- Under the current law and regulations in the PRC, **overseas outbound investments** shall be subjected to strict examination and approval in advance. For some investors, the complexity of the application procedure and the uncertainty of the approval timeline is an important factor that may influence their investment plans. After the related filing administrative rules come into effect for the Pilot FTZ, foreign investments will be monitored under the filing record mechanism instead of the advanced approval mechanism, which will alleviate some of the adverse effects that result from the pre-approval requirement. This will also send out a positive signal that will encourage Chinese enterprises to “go global”.
- **Open-up and innovation in the financial area** plays an important role in the Pilot FTZ. The Administrative Regulation stresses innovation and reform in RMB capital account convertibility, RMB cross-border usage, and interest rate liberalisation. Although the detailed rules are yet to be released, financial regulators and other supervisory bodies have proposed suggestions on the future development of the Pilot FTZ in the financial area. We believe that future detailed implementation measures will make the above financial innovation and reform related policies clearer and more manageable.
- **In terms of promoting the transformation of trade and the upgrading of the shipping centre function**, the Administrative Regulation only provides a high-level description on the related economic reforms (e.g. encouraging MNCs to set up their Asia-Pacific headquarters in the Pilot FTZ and integrating trade, logistics and settlement operation centres). It is anticipated that the detailed supporting policies and implementation measures will be gradually released after further consideration and analysis by the relevant authorities.
- The Administrative Regulation emphasises the elaboration of **"All-in-one" management** by the Administrative Committee, which aims to centralise the approval and management power of various administrative departments, such as approval for establishment and alteration of foreign-invested enterprises, establishment of enterprises during overseas outbound investments, recognition of hi-tech enterprises' qualifications, and management of intellectual property. Going forward, we expect that such administrative processes will be managed more efficiently.
- The Administrative Regulation points out that an **Annual Corporate Public Reporting System** will be launched in the Pilot FTZ, which requires enterprises in the zone to submit an annual report to the Industrial and Commercial Administration. As the annual report will be disclosed to the public, we advise that investors pay close attention to the promulgation of relevant provisions once they are released and consider the potential disclosure implications.

- An **Enterprise Credit Information System** will be adopted in the Pilot FTZ. By launching a credit reward/penalty mechanism, we expect to see the establishment of a more standardised, transparent and healthy business environment.

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