

# CHINA TAX ALERT

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## Pilot Free Trade Zone Series — Issuance of financial supporting policies for China (Shanghai) Pilot Free Trade Zone

### Regulations discussed in this issue:

- *Opinions of the People’s Bank of China on Providing Financial Support for the Development of China (Shanghai) Pilot Free Trade Zone*, issued on 12 December 2013

### Background

On 2 December 2013, the People’s Bank of China issued *Opinions of the People’s Bank of China on Providing Financial Support for the Development of China (Shanghai) Pilot Free Trade Zone* (hereinafter “the Regulation”), which sets out its financial supporting policies for the economic development of China (Shanghai) Pilot Free Trade Zone (hereinafter “the pilot zone”). Following the guidance of the *Framework Plan for the China (Shanghai) Pilot Free Trade Zone*, the Regulation indicated five focus areas along with detailed supporting measures: innovation in the bank account system, facilitation of foreign exchange conversion in investment and financing, expansion of cross border use of RMB, acceleration of interest rate liberalisation, and deeper reform of foreign exchange administration.

### Outlines of the Regulation

#### Highlights of the Regulation include:

#### Innovation in the bank account system

- Resident enterprises in the pilot zone can set up RMB and foreign currency free trade accounts to enable separate management of bank accounts and facilitate innovative investment and financing activities.
- Non-resident enterprises can set up RMB and foreign currency non-resident free trade accounts in the banks located in the pilot zone and enjoy the relevant financial services previously only available to domestic enterprises.
- Funds can be freely transferred between the resident free trade accounts and the following accounts: offshore accounts, non-resident accounts located within China but outside the pilot zone, non-resident free trade accounts and other resident free trade accounts.
- Fund transfers between resident free trade accounts and other bank settlement accounts of the same non-financial institution are allowed in cases of current account transactions, loan repayments, investments or other qualified cross-border transactions.

	<ul style="list-style-type: none"> <li>• Cross-border financing, guarantees or other related operations are allowed under resident free trade accounts and non-resident free trade accounts.</li> </ul>
<b>Investment, financing and conversion of foreign currency</b>	<p><u>Enterprises:</u></p> <ul style="list-style-type: none"> <li>• Enterprises in the pilot zone can apply for cross-border payment and foreign exchange conversion services directly through banks for cross-border direct investment purposes.</li> <li>• The overseas parent companies of enterprises in the pilot zone can issue RMB bonds in domestic capital markets in accordance with relevant national laws and regulations.</li> </ul> <p><u>Individuals:</u></p> <ul style="list-style-type: none"> <li>• Qualified Chinese individuals employed in the pilot zone can engage in various kinds of outbound investment, including security investments.</li> <li>• Qualified foreign individuals employed in the pilot zone can open non-resident individual specific inbound investment accounts in the financial institutions in the pilot zone and engage in inbound investment, including security investments.</li> </ul>
<b>The cross-border use of RMB</b>	<ul style="list-style-type: none"> <li>• Based on their understanding of the transaction, banking financial institutions in the pilot zone can provide cross-border RMB settlement services according to the collection and payment instructions issued by enterprises and individuals in the pilot zone for the purposes of current account transactions and direct investment.</li> <li>• Enterprises in the pilot zone can conduct mutual cash pooling business and centralised collection and payment for current account transactions with affiliated companies.</li> </ul>
<b>Interest Rate Liberalisation</b>	<ul style="list-style-type: none"> <li>• Financial institutions meeting the relevant conditions in the pilot zone shall be included in the scope of priority entities permitted to issue negotiable certificates with large-amount deposits.</li> <li>• When the timing is right, the upper limit on interest rates of small-amount deposits in foreign currencies under common accounts in the pilot zone shall be relaxed.</li> </ul>
<b>Foreign exchange administration</b>	<ul style="list-style-type: none"> <li>• The scope of pilot multi-national companies will be expanded for consolidated operation and management of foreign exchange funds and the management of cash pooling in foreign currencies will be further simplified.</li> <li>• Foreign exchange funds used for direct investment in the pilot zone may be settled at will. The pre-examination and approval procedures for the cross-border financial leasing transaction will be replaced with registration administration procedures.</li> <li>• With approval, financial leasing companies and Chinese leasing companies are allowed to charge rentals in foreign currencies for domestic financial</li> </ul>

	leasing. The procedures of advanced payment for large-scale financial leasing projects, such as those involving aircraft or ships, will be simplified.
<b>Financial institutions</b>	<ul style="list-style-type: none"> <li>• Financial institutions in Shanghai can open free trade accounts for enterprises in the pilot zone and provide relevant financial services by setting up separate pilot-zone accounting units.</li> <li>• Financial institutions in Shanghai can provide RMB settlement services for cross-border e-commerce (trading or service provision) in cooperation with payment institutions possessing a Payment Business License that covers the permitted business scope of internet payment in the pilot zone.</li> </ul>

### KPMG Observations

The Regulation represents an initial framework with regards to the financial supporting policies for the pilot zone. The subsequent detailed implementation regulations are yet to be issued by the authorities. We list the noteworthy points for the investors as follows:

The highlight of the Regulation is that by setting up separately-managed free trade accounts in the pilot zone, funds can be 1) freely transferred between free trade accounts and offshore accounts, and 2) transferred between free trade accounts and other domestic accounts outside the pilot zone under certain conditions. However, fund transfers between resident free trade accounts and other domestic accounts outside the pilot zone could still be subject to relevant regulations on cross-border transactions. Cross-border financing will be available for resident free trade accounts in the pilot zone, making investment and financing activities more efficient. However, overseas financing in RMB or foreign currency could still be subject to regulations in relation to foreign debt (i.e., within the debt-equity ratio). Furthermore, RMB borrowings should not be used to invest in negotiable securities or derivatives, or to provide entrusted loans.

Another highlight of the Regulation is the introduction of separate accounting units. This might enable financial institutions in Shanghai to open free trade accounts for resident enterprises in the pilot zone, Chinese and foreign individuals and overseas non-resident enterprises without an established entity in the pilot zone. Provision of innovative investment and financing services might also be allowed.

Although the Regulation covers a range of activities relating to investment, financing, cross-border RMB settlement and foreign exchange administration, the addition of individual capital account transactions adds a greater degree of openness. Chinese individuals working in the pilot zone and meeting the relevant conditions may carry out various types of overseas investments, including securities investments, in accordance with the Regulation. As a result, Chinese individuals may potentially no longer be subject to QDII or *Regulations on Foreign Exchange for Domestic Individuals' Participation in Equity Incentive Programs of Overseas Listed Companies*. On the other hand, foreign individuals may no longer be forced to invest in the Chinese stock market through QFII. The definition of pilot zone residents and investment limits have yet to be clarified in the upcoming implementation regulations.

Pilot operations of cash pooling in foreign currencies actually commenced before the launch of the pilot zone, but they usually came with relatively a high threshold and complicated administrative procedures. The Regulation intends to expand the scope of pilot enterprises for centralised management of foreign exchange funds and to further simplify the management of cash pooling in foreign currencies. However, it is still uncertain whether the follow-up implementation regulations will be able to normalise this particular business.

In terms of interest rate liberalisation, the Regulation states the intention to 1) further the construction of a system for interest rate liberalisation in the pilot zone based on the maturity of the relevant basic conditions, and 2) improve the monitoring mechanism for the liberalisation of interest rates for RMB and foreign currency funds in resident and non-resident free trade accounts in the pilot zone. However, the Regulation does not provide detailed explanations and only mentions allowing the issuance of negotiable certificates with large-amount deposits and the relaxation of interest rates for small-amount deposits in foreign currencies. As interest rate liberalisation will have a key impact on market resource distribution, it is still uncertain how a relaxation of the upper limit on interest rates will be achieved.

In general, the purpose of the Regulation is to serve the real economy and facilitate cross-border investment and trading, while at the same time managing the risks. We think the Regulation provides business development opportunities to financial institutions in Shanghai, as well as planning opportunities that will allow enterprises to improve efficiency in fund utilisation. KPMG will continue to provide further analysis and insights on the subsequent implementation regulations.

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