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CHINA TAX ALERT

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Pilot Free Trade Zone Series — Future outlook for China (Shanghai) Pilot Free Trade Zone

Background

Since the Shanghai Municipal Government and relevant State authorities released the first batch of policies governing the (Shanghai) Pilot Free Trade Zone (SPFTZ) in late September, it has subsequently issued further specific notices in order to promote the six major sectors (e.g. shipping, professional services, and the culture and entertainment industries).

The purpose of this China Tax Alert is not to discuss in detail the notices that have been issued to date, but to highlight what we believe the key future policies may encompass and in which key areas we expect further elaboration to be announced.

Key points

1) **Opening up and innovation in the financial services sector**

   As stipulated in the Administrative Measures of SPFTZ, some of the key financial services related measures are expected to include:

   - RMB convertibility
   - Interest rate liberalisation
   - Cross-border use of RMB
   - Foreign debt control relaxation
   - Cross-border financing.

   However, to date, the detailed implementation procedures are yet to be released in full and further clarification is needed for both investors and financial institutions. In order for the government to release further guidance on the above, we believe that they would first need to address issues such as management of the related risks and establishing how fund flows will operate between the FTZ and overseas/mainland China, as well as questions regarding liquidity, the loan deposit ratio and whether bank restrictions should be further relaxed. It is anticipated that The People's Bank of China (PBOC) and the State Administration of Foreign Exchange (SAFE) will release policies to address these issues in the near future, likely before the end of 2013.

2) **To accelerate transformation of trading**

Another key aspect of the SPFTZ is to promote the establishment of regional headquarters and to promote certain industries, particularly the finance leasing, commodity trading and logistics industries. However, in order to ensure that the SPFTZ remains competitive against other FTZs or traditional regional hub locations such as Hong Kong or Singapore, the key critical issue to be resolved would be foreign exchange polices in terms of debt and fund flow or whether further incentives/concessions would be granted. Again, the announcement of the related PBOC/SAFE policies will be critical in this respect.

3) **Opening up new investment opportunities**

It is discouraging for some foreign investors that the first-released Negative List largely mirrors the current categories for restricted and prohibited projects in the Catalogue of Industries for Guiding Foreign Investment ("the Catalogue"). However, it is likely that the list will be modified in the future, allowing the opening up of other sectors. In addition, we should also see supplementary policies to further encourage outbound-type investments.

KPMG observations

Investors are clearly confident about the future of the SPFTZ, with over 600 companies already registered within the zone at the end of November 2013. However, despite the strong driving power and expectations of investors (both foreign and domestic), it is evident that the government remains extremely prudent in terms of announcing more detailed guidance on some of its key framework principles. Further practical implementation guidance would therefore be welcomed, especially with respect to cross-border financing issues.

Once the above issues are addressed, we believe that there will be significant opportunities for various sectors. This is particularly true for the financial services sector, where we would expect to see new types of financial products and services, as well as new forms of investment. This would also mean that the treasury function of companies would have more opportunities and new business models to explore.

Another major question on investors' minds is whether China will be introducing additional FTZs across the nation. The Third Plenum of the Communist Party of China's 18th Central Committee clearly indicated that more FTZs will open up in future in areas such as Guangdong, Xiamen or Tianjin, but to a certain extent, this still depends on the success of the SPFTZ.

KPMG will continue to observe the related regulations and provide further insights in the upcoming China Tax Alert issues.

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