

CHINA TAX ALERT

ISSUE 22 | August 2014

Pilot Free Trade Zone Series — Regulation for China (Shanghai) Pilot Free Trade Zone has been released

Regulations discussed in this issue:

- *Regulation for China (Shanghai) Pilot Free Trade Zone, The Shanghai Standing Committee of the NPC Announcement [2014] No. 14, issued on 25 July 2014*

Background

The 14th Shanghai Standing Committee of the National People's Congress approved the Regulation for China (Shanghai) Pilot Free Trade Zone ('the Regulation') on 25 July 2014, effective 1 August 2014.

The Regulation is first local regulation for the China (Shanghai) Pilot Free Trade Zone (SH Pilot FTZ) and contains nine chapters and 57 articles. To promote the construction of the SH Pilot FTZ, it outlines the management system, openness to investment, trade facilitation, financial service, management of taxation, comprehensive supervision and legal environment, and is to be regarded as the basic law of the SH Pilot FTZ.

The Regulation does not only summarise existing regulations for the SH Pilot FTZ but also foreshadows the innovation of the policies. The Regulation provides the legal framework for the reform of the SH Pilot FTZ, strengthening the confidence of investors and raising expectations for the development of the SH Pilot FTZ.

What are the highlights in the Regulation?

- Encouraging innovative activities in the areas not prohibited by laws, regulations and rules
- Adjusting the negative list in a timely fashion
- Facilitating business registration
- Deepening reform of the supervision of customs, inspection and quarantine
- Pursuing the one-stop service model for international trade
- Continuing the five financial innovations
- Studying the tax policy to adapt the overseas equity investment and offshore business development
- Introducing six supervision mechanisms

The Regulation integrates the current published regulations in the FTZ, and indicates directions for the subsequent reform policies. We will illustrate the main content of the Regulation in the appendix.

KPMG's observations

The SH Pilot FTZ has been introduced for nearly a year and the issuance of the Regulation further integrates and enhances the existing reform policies for the SH Pilot FTZ. Moreover, the Regulation provides a set of robust laws and regulations system security to deepen the reform and innovation of the SH Pilot FTZ as well as ensure the subsequent experimental work can be successfully carried out under the legal framework.

The Regulation covers all the existing duplicable and promotable systems and management modes, and makes space for further innovation. With regard to the five financial innovations, the implementation measures for the establishment of free trade account (FTA) system, the cross-border use of RMB and the reform of foreign exchange administration have been clarified and the related businesses have been operating in the SH Pilot FTZ. However, the rules for facilitation of cross-border investment and financing activities as well as interest rate liberalisation are still not clear, and the release of the Regulation provides some guidance for the future policy development.

The Administrative Committee of the SH Pilot FTZ is expected to release its list of mandates soon, clarifying how the administrative committee will exercise administrative approval and penalty authority. Investors will gain investment confidence with support of laws and the anticipation of the system innovation. Development of the SH Pilot FTZ is something worth looking forward to.

Appendix: Main Articles in the Regulation

Chapter	Main content
Management System	• The Administrative Committee of the SH Pilot FTZ works as a dispatched department of the Shanghai municipal government • Customs, inspection and quarantine, maritime affairs, border inspection, industry & commerce, quality supervision, tax and public security will set up departments in the SH Pilot FTZ
Openness to Investment	• Further open up such fields as financial services, shipping services, trade services, professional services, cultural services, public sector services and general manufacturing; suspend, eliminate, and loosen certain access restrictions • Adjust negative list where necessary • Establish united window mechanism for administrative affairs, under which the approval (record filing) of foreign-funded projects and approval (record filing) for the establishment and alteration of enterprises shall be processed under a “one-stop” mode • Implement a system for registration of capital subscription • Unless otherwise provided for by law, an investor may decide on its own operation period for foreign-funded enterprise in the SH Pilot FTZ • Enterprises established in the SH Pilot FTZ can re-invest or have business operations outside
Trade Facilitation	• Customs : - Open up the front line, efficient control in the second line, and free flow within the SH Pilot FTZ - Establish a classified supervision system based on the status of goods, which will feature electronic network management, paperless clearance and low-risk, high-speed passage - Allow an enterprise bringing goods into the SH Pilot FTZ from outside China by presenting the manifests and then going through declaration formalities step by step - Require that goods to be exported via ports have a customs declaration made first before goods are transported into the ports - Adopt a supervision system featuring entry/exit record list comparisons, enterprise book management and a digital information network for goods transported from the SH Pilot FTZ to areas in China - Impose no time limitations on goods under bonded warehousing in the SH Pilot FTZ • Inspection and Quarantine : - Goods that enter the SH Pilot FTZ from outside China shall go through entry inspection if required; other goods are exempted from inspection unless they are classified as key and sensitive goods - Goods that exit the SH Pilot FTZ shall have pre-inspected upon their application, with verification and clearance in batches - Bonded exhibition goods that enter/exit the SH Pilot FTZ are exempted from inspection - Warehoused logistic goods being transported between enterprises in the SH Pilot FTZ are exempted from inspection - An administration system that helps with the development and standardisation of third-party evaluation agencies will be established, and the evaluation results of third-parties will be admitted according to international practices • International and domestic trade : - Introduce united window mechanism for international trade to create a cross-department administrative platform to serve trade, transport, processing, warehousing and other businesses - Support upgrading of basic businesses such as international trade, warehousing

	and logistics, processing and manufacturing, as well as the development of service trade - Encourage the development of new-types of businesses, such as offshore trade, international trade of bulk commodities, financial leasing, bonded delivery of futures, cross-border e-business - Push forward outsourced businesses such as R&D of bio-medicine, software and information service and data processing • International Shipping : - Support businesses including international transit, assembly and distribution, as well as container transit and international transit of air cargo - Allow qualified shipping enterprises to engage in piggyback shipping of import/export containers between other domestic coastal ports and Shanghai Port - Adopt an international vessel registration system taking "China Yangshan Port" as the port of registry in the SH Pilot FTZ and establish an efficient registration process. • Talent Acquisition : - Simplify employment approval formalities for foreigners - Loosen limitations on the terms of visas and residence permits
Financial Service	• Build an FTA system in favour of risk management: - Establish an account-based settlement mechanism to facilitate capital transfers between FTAs and foreign accounts, and amongst institutional accounts outside the FTZ for non-residents • Simplify the procedure of currency exchange in investment, improving currency exchange facilitation in investment and financing: - Various units in the SH Pilot Zone can conduct cross-border investment and finance business • Encourage cross-border use of RMB - Simplify formalities for cross-border RMB use under current and direct investment accounts - Allow RMB borrowing by financial institutions or enterprises from overseas - Conduct cross-border mutual RMB cash pooling, and centralised collection and payment for current account transactions • Promote the building of market interest rate liberalisation - Remove the interest rate ceiling for foreign currency deposits and possibly give a qualified financial institution priority in issuing large-amount transferrable deposits • Establish the foreign exchange management system suitable for the development needs of the SH Pilot Zone - Simplify documentation review under current accounts as well as the foreign exchange registration procedures for direct investment - Relax the management of foreign claims and liabilities - Improve the management of the centralised operation and management of foreign exchange funds by the headquarters of multinational companies, foreign currency cash pooling and the international trade settlement centre - Improve the administration of foreign exchange sale and settlement, and facilitate the over-the-counter commodity derivatives transaction services
Management of taxation	• Research the tax policies adopted on overseas equity investments and offshore business development to avoid profit erosion and shifting of tax bases • Conduct tax centralised approval procedures, cancel pre-examination step-by-step, carry out "check after approval" and separate the approval from verification method
Comprehensive Supervision	• Transfer the government management from prior approval to middle and post supervision: - National security review system - Anti-monopoly work mechanism

	- Strengthening of credit management - Disclosure of annual reports by enterprises and a list of enterprises with abnormal business operations - Establishment of supervision information sharing and comprehensive law enforcement system - Implementation of market supervision system with participation of social forces
--	--

Khoonming Ho

Partner in Charge, Tax
China and Hong Kong SAR
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Beijing/Shenyang David Ling

Partner in Charge, Tax
Northern China
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Qingdao Vincent Pang

Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Shanghai/Nanjing Lewis Lu

Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Chengdu Anthony Chau

Tel. +86 (28) 8673 3916
anthony.chau@kpmg.com

Hangzhou John Wang

Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Guangzhou Lilly Li

Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen Maria Mei

Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Shenzhen Eileen Sun

Partner in Charge, Tax
Southern China
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong Karmen Yeung

Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern China

David Ling

Partner in Charge, Tax
Northern China
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Vaughn Barber

Tel. +86 (10) 8508 7071
vaughn.barber@kpmg.com

Roger Di

Tel. +86 (10) 8508 7512
roger.di@kpmg.com

John Gu

Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Kevin Lee

Tel. +86 (10) 8508 7536
kevin.lee@kpmg.com

Paul Ma

Tel. +86 (10) 8508 7076
paul.ma@kpmg.com

Vincent Pang

Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Michael Wong

Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Jessica Xie

Tel. +86 (10) 8508 7540
jessica.xie@kpmg.com

Irene Yan

Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Tracy Zhang

Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Abe Zhao

Tel. +86 (10) 8508 7096
abe.zhao@kpmg.com

Eric Zhou

Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

David Chamberlain

Tel. +86 (10) 8508 7056
david.chamberlain@kpmg.com

Tony Feng

Tel. +86 (10) 8508 7531
tony.feng@kpmg.com

Li Li

Tel. +86 (10) 8508 7537
li.li@kpmg.com

Alan O'Connor

Tel. +86 (10) 8508 7521
alan.oconnor@kpmg.com

Joseph Tam

Tel. +86 (10) 8508 7605
laiyi.tam@kpmg.com

Anni Wang

Tel. +86 (10) 8508 7518
anni.wang@kpmg.com

Sheila Zhang

Tel. +86 (10) 8508 7507
sheila.zhang@kpmg.com

Tiansheng Zhang

Tel. +86 (10) 8508 7526
tiansheng.zhang@kpmg.com

Central China Lewis Lu

Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Anthony Chau

Tel. +86 (21) 2212 3206
+86 (28) 8673 3916
anthony.chau@kpmg.com

Cheng Chi

Tel. +86 (21) 2212 3433
cheng.chi@kpmg.com

Chris Ho

Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Ho Yin Leung

Tel. +86 (21) 2212 3358
hoyin.leung@kpmg.com

Sunny Leung

Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Christopher Mak

Tel. +86 (21) 2212 3409
christopher.mak@kpmg.com

Henry Ngai

Tel. +86 (21) 2212 3411
henry.ngai@kpmg.com

Brett Norwood

Tel. +86 (21) 2212 3505
brett.norwood@kpmg.com

Yasuhiko Otani

Tel. +86 (21) 2212 3360
yasuhiko.otani@kpmg.com

John Wang

Tel. +86 (21) 2212 3438
john.wang@kpmg.com

Jennifer Weng

Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

Grace Xie

Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Bruce Xu

Tel. +86 (21) 2212 3396
bruce.xu@kpmg.com

William Zhang

Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

Michelle Zhou

Tel. +86 (21) 2212 3458
michelle.b.zhou@kpmg.com

Cheng Dong

Tel. +86 (21) 2212 3410
cheng.dong@kpmg.com

David Huang

Tel. +86 (21) 2212 3605
david.huang@kpmg.com

Dylan Jeng

Tel. +86 (21) 2212 3080
dylan.jeng@kpmg.com

Amy Rao

Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Henry Wong

Tel. +86 (21) 2212 3380
henry.wong@kpmg.com

Southern China Eileen Sun

Partner in Charge, Tax
Southern China
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Vivian Chen

Tel. +86 (755) 2547 1198
vivian.w.chen@kpmg.com

Sam Fan

Tel. +86 (755) 2547 1071
sam.kh.fan@kpmg.com

Angie Ho

Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Jean Jin Li

Tel. +86 (755) 2547 1128
Tel. +86 (592) 2150 888
jean.j.li@kpmg.com

Lilly Li

Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Kelly Liao

Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Bin Yang

Tel. +86 (20) 3813 8605
bin.yang@kpmg.com

Penny Chen

Tel. +86 (755) 2547 1072
penny.chen@kpmg.com

Grace Luo

Tel. +86 (20) 3813 8609
grace.luo@kpmg.com

Maria Mei

Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Michelle Sun

Tel. +86 (20) 3813 8615
michelle.sun@kpmg.com

Lixin Zeng

Tel. +86 (20) 3813 8812
lixin.zeng@kpmg.com

Hong Kong

Ayesha M. Lau

Partner in Charge, Tax
Hong Kong SAR
Tel. +852 2826 7165
ayasha.lau@kpmg.com

Chris Abbiss

Tel. +852 2826 7226
chris.abbiss@kpmg.com

Darren Bowdern

Tel. +852 2826 7166
darren.bowdern@kpmg.com

Barbara Forrest

Tel. +852 2978 8941
barbara.forrest@kpmg.com

Daniel Hui

Tel. +852 2685 7815
daniel.hui@kpmg.com

Charles Kinsley

Tel. +852 2826 8070
charles.kinsley@kpmg.com

John Kondos

Tel. +852 2685 7457
john.kondos@kpmg.com

Alice Leung

Tel. +852 2143 8711
alice.leung@kpmg.com

Curtis Ng

Tel. +852 2143 8709
curtis.ng@kpmg.com

Kari Pahlman

Tel. +852 2143 8777
kari.pahlman@kpmg.com

John Timpany

Tel. +852 2143 8790
john.timpany@kpmg.com

Wade Wagatsuma

Tel. +852 2685 7806
wade.wagatsuma@kpmg.com

Lachlan Wolfers

Tel. +852 2685 7791
lachlan.wolfers@kpmg.com

Christopher Xing

Tel. +852 2978 8965
christopher.xing@kpmg.com

Karmen Yeung

Tel. +852 2143 8753
karmen.yeung@kpmg.com