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Ashurst China Desk

# Rules for Shanghai Free Trade Zone Finally Unveiled

Ever since the State Council gave the green light to the establishment of the mainland's first real free trade zone in Shanghai in July 2013, the details of the plan governing the free trade zone have been highly anticipated. On 27 September 2013, the State Council released the General Plan for the China (Shanghai) Pilot Free Trade Zone (the **"General Plan"**). The General Plan sets out a roadmap for the regulatory reforms in the China (Shanghai) Pilot Free Trade Zone (the **"FTZ"**), which officially opened on 29 September 2013 and went into operation on 1 October 2013. In the meantime, the Shanghai Municipal Government, the State Administration for Industry and Commerce and other government authorities also respectively announced measures to support the FTZ.

Based on the General Plan and the supplementary measures, we set out below a summary of the key policy initiatives for the FTZ.

## Further opening up of certain service sectors

Pursuant to the General Plan, the following service sectors will be further opened up to foreign investment, with market access restrictions (such as requirements concerning the qualification of investors, limitations on foreign participation, restrictions concerning business scope, etc.) removed:

| Sector | Type of Service | Details |
|---|---|---|
| Financial Services | Banking services | • Qualified foreign financial institutions may set up wholly foreign-owned banks and Sino-foreign equity joint venture banks with eligible Chinese private capital; and<br>• Qualified Chinese banks may operate in offshore business. |
| | Health and medical insurance | • Foreign investors may set up specialized health and medical insurance institutions. |
| | Financial leasing | • Removal of the minimum registered capital requirement for a project company (i.e. single-ship/aircraft company); and<br>• Financial leasing companies may conduct commercial factoring relating to its primary businesses. |
| Shipping Services | Ocean transportation | • Limitations on foreign participation in Sino-foreign joint venture international shipping enterprises will be relaxed. |
| | International ship management | • Foreign investors may set up wholly foreign-owned ship management enterprises. |
| Commerce and Trade Services | Value-added telecommunications | • Qualified foreign-invested enterprises ("**FIEs**") may engage in specific value-added telecommunication services |
| | Entertainment and gaming consoles sales and service | • FIEs may engage in the manufacturing and sales of entertainment and gaming consoles. |

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| Professional Services | Law firms | • New way of cooperation between foreign and domestic law firms |
| | Credit investigation | • Foreign investment is permitted. |
| | Travel agency | • Sino-foreign equity joint venture travel agencies may engage in overseas tourism businesses, with the exception of Taiwan. |
| | Recruitment agency | • Restrictions on foreign participation and minimum registered capital are relaxed. |
| | Investment management | • Foreign-invested equity investment companies may be structured as companies limited by shares. |
| | Engineering design | • Restrictions on the qualification of the investors are removed. |
| | Construction service | • Wholly foreign-owned construction enterprises may conduct Sino-foreign joint construction projects in Shanghai without the limitation on foreign participation in the project |
| Cultural Services | Talent agency | • Wholly foreign-owned talent agencies may be set up to provide services in Shanghai. |
| | Entertainment facilities | • Wholly foreign-owned entertainment facilities may be set up to provide services in the FTZ. |
| Social Services | Education and training, vocational skills training | • Establishment of Sino-foreign cooperative joint venture education and training institutions is permitted; and<br>• Establishment of Sino-foreign cooperative joint venture vocational skills training institutions is permitted. |
| | Medical services | • Establishment of wholly foreign-owned medical institutions is permitted. |

## Negative list approach for foreign investment management

According to the General Plan, a negative list approach towards foreign investment management will be adopted in the FTZ, meaning that foreign investors are allowed to invest in every sector that is not on the negative list and enjoy national treatment in terms of market entry in the FTZ. The 2013 version of the negative list (the **"Negative List"**) has been issued by the Shanghai Municipal Government, which covers 16 service sectors and details 190 management measures. Of the 190 management measures, 38 measures are marked as "prohibited" and 74 are marked as "restricted".

The Negative List appears to be slightly disappointing to the market because it is longer and more restricted than expected. Foreign investors are still prohibited from investing in the country's tightly-controlled cultural, sports and entertainment industries, such as news agencies, radio and film companies, publishing of newspapers, magazines and books, production of electronic publications, internet bars, and so on.

Moreover, foreign investment is still restricted in industries such as telecommunication, broadcast and television, satellite transmission service and high-end properties.

However, the Negative List is not final and will be adjusted from time to time. According to Professor Chen Bo, the Vice Director of the Research Centre of the FTZ, compared to the negative lists used by other economies in the world, the Negative List uses the word "restricted" much more frequently than the word "prohibited", which should allow more room for interpretation. [1]We expect that the Negative List may become shorter in the future.

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[1] Please refer to http://news.ifeng.com/shendu/21sjjjbd/detail_2013_10/01/30031518_0.shtml

## Removal of approvals for foreign investment and outbound investment

Under the country's current legal regime, foreign investment is subject to approval of the approval authorities, the process of which is not straightforward and notoriously time-consuming. According to the General Plan, foreign investment in the FTZ will be administered under a "record filing" mechanism by the Shanghai local authorities.

More specifically, for foreign-invested projects in the FTZ in sectors not listed on the Negative List, the previous approval system will be replaced by a record-filing system. According to the *Administrative Measures on Record Filing of Foreign-invested Projects in the China (Shanghai) Pilot Free Trade Zone* issued by the Shanghai Municipal Government on 29 September 2013, such foreign-invested projects include Sino-foreign equity joint ventures, Sino-foreign cooperative joint ventures, wholly foreign-owned projects, acquisition of domestic enterprises by foreign investors, capital increase of FIEs and so on, and the Administrative Committee of the FTZ is responsible for the filing of such projects. The applicant of a foreign-invested project should fill in and submit a standard record-filing form, as well as provide the requisite application materials, to the Administrative Committee. The Administrative Committee should respond within 10 business days and issue an opinion to the applicant regarding the filing of such project.

Also, the joint venture contracts and articles of association of FIEs will only need to be filed with, rather than approved by, the relevant authorities. According to the *Administrative Measures on Record Filing of Foreign-invested Enterprises in the China (Shanghai) Pilot Free Trade Zone* issued by the Shanghai Municipal Government on 29 September 2013, the Administrative Committee of the FTZ is also responsible for the record filing of FIEs in the FTZ which invest in sectors not listed on the Negative List. An FIE can, after obtaining a pre-approval for its corporate name, log in the Administrative Committee's online system to fill in the relevant information. The Administrative Committee should put the relevant information on file within one business day, and send a record-filing certificate to the foreign investor and relevant authorities through its online system.

According to Mr. Dai Haibo, Vice Secretary General of the Shanghai Municipal Government, under the record-filing mechanism an enterprise may be established (i.e. obtaining its business license, organizational code certificate, tax registration certificate and other requisite post-registration certificates) in four days at the soonest, while it would take at least 29 days for a project to be approved under the original approval system.[2]

In addition, the approval requirements on outbound investment are also removed in the FTZ. Instead, investors in the FTZ will only need to file the investment project with the Administrative Committee of the FTZ. Investors are also encouraged to establish special purpose vehicles in the FTZ to conduct outbound equity investment and qualified investors are encouraged to set up outbound equity investment funds. The Shanghai Municipal Government has issued the relevant measures[3] regarding the record-filing of outbound investment to specify the procedures and requirements.

## Other policy initiatives

Other key policies in the General Plan include:

**Convertible RMB capital account:** According to the General Plan, on the condition that risks can be controlled, enterprises can undertake convertibility of RMB on the capital account on a "first-to-do and first-to-try"[4] basis within the FTZ. Under the country's current foreign exchange regulatory system, conversion between RMB and a foreign currency is already permitted for current account transactions, but is subject to approval for capital account transactions, such as foreign equity investment and foreign debts. The General Plan does not say whether full convertibility of RMB on the capital account is permitted, which shows that the central government is still cautious about the potential risks of greater convertibility.

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[2] Please refer to http://finance.sina.com.cn/china/20130929/154116884909.shtml.

[3] The Administrative Measures on Record Filing of Outbound Investment Projects in the China (Shanghai) Pilot Free Trade Zone and the Administrative Measures on Record Filing of Outbound Investment in Establishing Enterprises in the China (Shanghai) Pilot Free Trade Zone.

[4] According to the relevant news reports, although convertibility of the capital account has long been set as one of the targets of the reform of China's financial industry for the period between 2011 and 2015, it has not yet been settled as to how to proceed with this important reform. "First-to-do and first-to-try" means that the FTZ will be the pilot zone for the Chinese government to experiment, and the relevant experience gained from the FTZ will be used in other parts of China. Please refer to http://news.xinhuanet.com/fortune/2013-09/08/c_117274759.htm.

**Facilitation of customs supervision:** In China's existing bonded zones, the entry and exit of goods are under customs supervision. According to the General Plan, the imported goods will be allowed to enter into the FTZ prior to getting customs declared. Customs supervision will also be streamlined.

**Favorable tax policies:** Pursuant to the General Plan, special tax policies related to income taxes (including corporate income tax (**"CIT"**) and individual income tax), import-level taxes and export tax refund will be implemented in the FTZ to promote investment and trade development. However, a reduced CIT rate of 15% to be applied to enterprises within the FTZ as rumored earlier is not offered in the General Plan.

**Interest rate liberalization:** According to the General Plan, the FTZ can also realize market-oriented financial market rates, and pricing can be done by financial institutions on market needs.

## Conclusion

The General Plan is a high-level government policy, and not detailed implementing rules. Much remains unclear and ambiguous in the General Plan. For example, the General Plan talks about favorable tax policies for the FTZ, but provides no material terms such as preferential tax rates; also, there are no detailed measures on how to carry out certain financial innovations in the FTZ, such as interest rate liberalization. Therefore, the specific rules implementing the General Plan will be subject to further evaluation by the relevant authorities and remain to be seen. Having said that, there is no doubt that the FTZ will play an important role in China's next round of reforms and opening up. The relaxation of certain restrictions on foreign investment and the adoption of a "negative list" approach will create a more investor-friendly environment for a number of sectors. Companies may wish to take this opportunity to re-evaluate the structuring and operation of their businesses in China.

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