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## Foreign Direct Investment Law

### General Summary on New Policies in China (Shanghai) Free Trade Zone

Kelvin GAO | Shu WANG | Lynn TENG

On August 22, 2013, the State Council of the People's Republic of China officially approved the establishment of the China (Shanghai) Free Trade Zone (the "FTZ").<sup>1</sup> At the same time, in order to facilitate the smooth implementation of the reform measures in the FTZ, the Standing Committee of the National People's Congress issued the *Decision on Authorizing the State Council to Temporarily Adjust the Administrative Examination and Approval of Relevant Laws in the China (Shanghai) Free Trade Zone* (the "Decision") on August 30, 2013. The Decision officially authorizes the State Council to suspend several examination and approvals items with respect to foreign invested enterprises (the "FIEs") as provided under the *PRC Law on Wholly Foreign-owned Enterprises*, the *PRC Law on Sino-foreign Equity Joint Ventures* and the *PRC Law on Sino-foreign Contractual Joint Ventures*. In addition, the State Council has officially issued the *Notice on Printing and Publicizing the General Planning of China (Shanghai) Free Trade Zone* on September 27, 2013 (the "Notice").

Based on the relevant content contained in the Decision and the Notice, combined with our previous study on the FTZ, below is a brief summary of the new policies to be implemented in FTZ, which will generally consist of the following aspects:

#### Strengthen Financial System Reform and Innovation

The core innovation policy of the FTZ will be financial system reform. The main features of financial reform in the FTZ are as follows:

##### 1) Accelerating financial system innovation

- (a) provided that the risk is under control, to realize the free convertibility of Renminbi capital

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<sup>1</sup> The FTZ contains four existing customs surveillance areas (i.e., Shanghai Waigaoqiao Bonded Zone, Shanghai Waigaoqiao Bonded Logistics Park, Yangshan Port Bonded Zone and Pudong Airport Comprehensive Bonded Zone).

account, marketization of interest rate in the financial market and Renminbi cross-border pilot projects;

- (b) to realize the implementation of marketization pricing on the assets of financial institutions;
- (c) to establish a foreign exchange administration system which will adapt to the FTZ and to completely facilitate trade and investment;
- (d) to encourage enterprises to realize free cross-border financing and to further facilitate cross-border financing;
- (e) to deepen the pilot projects of centralized operation and management of foreign exchange capital of multinational company headquarters and to encourage multinational companies to set up regional or worldwide capital management centres;

## **2) strengthening the functions of financial services**

- (a) to promote the financial services industry in being completely open to qualified private capital and foreign investment financial institutions and to support the establishment of foreign invested banks as well as Sino-foreign joint venture banks;
- (b) to allow the establishment of transaction platforms for the financial market within the FTZ;
- (c) to generally allow overseas enterprises to participate in commodity futures trading;
- (d) to encourage product innovation in the financial market;
- (e) to support the establishment of integrated financial services platform within the FTZ by equity trustees and trading institutions;
- (f) to support the operation of the business of Renminbi cross-border reinsurance and to foster and develop the reinsurance market;
- (g) to allow the establishment of restricted license banks<sup>2</sup> (which are preliminarily estimated to be banks holding certain Renminbi business licenses) where the relevant conditions are satisfied;
- (h) to allow the establishment of foreign investment professional health and medical insurance institutions;
- (f) to allow certain Chinese banks to carry out off-shore business activities;<sup>3</sup>
- (g) to encourage the business of financial leasing and granting tax support;

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<sup>2</sup> A "Restricted License Bank" is designed to make certain companies (i.e., small loan companies) which have a consolidated foundation but whose business scale is not so big as banks to be qualified to apply to become a restricted license bank (such banks may receive deposits in a certain amount and without depositing term limitations) or a deposit taking company. Such companies may receive deposits from local residents or carry out the business of wholesale and investment banking.

<sup>3</sup> "Offshore Business" refers to the financial activities of banks receiving funds from non-residents and providing services for non-residents.

It should be noted that, the Notice states that reform and innovation within the FTZ shall be carried out by way of prior to carry and try, risk under control, step-by-step promotion and gradual development. Therefore, we understand the relevant implementation of such reform and innovation needs to be further embodied and put into practice with the development of the administration system in the FTZ and the accumulation of relevant experience.

### **Simplify Certain Approval Procedures for Foreign Investments**

In contrast to the existing approval system regarding onshore investments by foreign investors, the FTZ will adopt an administration model called the “Negative List Administration”. This “Negative List Administration” will be “permitted as long as the relevant laws and regulations have no explicit prohibitions”. Specifically, within the FTZ, except for those key industries which are explicitly restricted/prohibited from foreign investment, foreign investments in other industries will not be subject to any approval and only filing is necessary. Therefore, the FTZ will implement an administrative model of “approval + filing” in regard to foreign investment access. We have listed below the approval items which may be suspended in the FTZ:

#	Suspended Approval Item	Main Content	Existing Rules
1.	Examination and approval on foreign investment projects conducted by the National Development and Reform Commission (the “NDRC”) or its local counterparts	In the FTZ, based on the principle of “same treatment on Domestic and Foreign investment projects”, foreign investment projects may no longer be subject to approval. Instead, only a filing procedure is required to be carried out (other than those projects reserved to be approved by the component authority). The Shanghai Municipal People’s Government will be responsible for such filing	Various foreign investment projects (including the establishment and alteration of FIEs and foreign mergers & acquisitions) shall be subject to the project approval of the NDRC or its local counterparts <sup>4</sup>
2.	Approval on the establishment, alteration and termination of an FIE	According to the Decision, the following approval items regarding FIEs (including wholly foreign-owned enterprises (“WFOEs”), Sino-foreign equity joint ventures (“EJVs”) or Sino-foreign contractual joint ventures (“CJVs”) will be replaced by filing: <sup>5</sup> <ul style="list-style-type: none"> <li>• the establishment, division, merger, alteration, and determination and extension of the operation term of the WFOEs;</li> <li>• the establishment, extension of duration and dissolution of EJVs;</li> <li>• the establishment of and major</li> </ul>	Establishment, alteration and termination of an FIE shall be subject to the approval of the competent approval authorities

<sup>4</sup> In practice, under certain circumstances, some foreign investment projects do not need to apply for project approval from the NDRC or its local counterparts.

<sup>5</sup> The Decision will come into effect on October 1, 2013. We understand that the State Council will then adjust and promulgate a series of regulations regarding the establishment, alteration and termination of FIEs based on the principles established by the Decision.

#	Suspended Approval Item	Main Content	Existing Rules
		changes to the agreement, contract or articles of association of the CJVs, transfer of rights and obligations under the CJVs' contract, entrusted operation and extension of duration	
3.	Approval on outbound investment	Outbound investment by domestic enterprises will be just subject to a filing requirement, which the Shanghai Municipal People's Government will be responsible for	When conducting outbound investments, a domestic enterprise should first obtain the approval from the NDRC or its local counterparts and the competent PRC approval authorities. Such enterprise will then need to obtain a foreign exchange registration certificate of its outbound direct investment issued by the competent foreign exchange authority. Upon obtaining all of the above-mentioned approvals and certificates, such enterprise may carry out the procedure of remittance of funds in the appointed foreign exchange banks

On the other hand, the Notice stipulates that the State safety inspection system shall be improved in the FTZ and the anti-monopoly examination of the acts of the concentration of business operators shall be strictly executed so as to constitute an internationally compatible foreign investment regulation system.

Notably, the Notice keeps silent about the execution of the cancellation of the examination and approval items. Therefore, we understand that the relevant regulations and rules will need to be further embodied and put into practice.

### **Expand Areas for Foreign Investment and Lower Threshold for Market Access**

As previously mentioned, after the implementation of the "Negative List", any foreign investment project in the FTZ which is beyond such list may not be subject to the relevant existing restrictions on market access for foreign investment.

According to published information, we noted that the access threshold or restrictions on the qualifications, shareholding, business scope, etc. for foreign investment may be lowered or removed in the following areas:

Service Scope		Industry	Rules in FTZ	Existing Rules
Financial Services	1.	Banking	Allow the setting up of wholly foreign investment banks and establishments of Sino-foreign investment banks with domestic banks	According to the <i>PRC Administrative Regulations on Foreign Investment Banks</i> and its implementing rules, it is generally allowed to set up foreign invested banks and Sino-foreign invested banks in China provided that certain requirements stipulated in these regulations and rules are satisfied, which include, among others, the minimum amount of registered capital for these banks (RMB1 billion or in a freely convertible currency equivalent to that amount) and satisfying the operation qualifications, financial conditions, and investment experiences within China of the investors
			Allow the establishment of restricted license banks where the relevant conditions are satisfied	Currently there are no regulations on the establishment of restricted license banks in China, nor is there any restricted license bank established in China
			Allow certain qualified domestic banks to carry out off-shore business activities	Only the four pilot banks, i.e. China Merchants Bank, Shenzhen Development Bank, Shanghai Pudong Development Bank and Bank of Communications have obtained permission to carry out off-shore business activities
	2.	Health Insurance	Allow the establishment of foreign-funded health or medical insurance institutions as pilot projects	According to the <i>Catalogue for the Guidance of Foreign Investment Industries</i> (the "Catalogue"), insurance companies fall within the "restricted" category, and the shareholding ratio held by foreign investors shall be no more than 50% in a life insurance company
	3.	Finance Lease	No requirement on the minimum amount of registered capital for financial leasing companies to set up single plane or single ship subsidiaries	According to the <i>Notice on the Relevant Issues on the Establishment of Project Companies within the Bonded Area by the Financial Leasing Companies to Operate the Business of Financial Leasing</i> issued by the China Banking Regulatory Commission (the "CBRC"), those financial leasing companies which are under the supervision of the CBRC may set up project subsidiaries in the form of single plane or single ship companies, but only within the bonded area, while financial leasing companies which are under the supervision of the Ministry of Commerce are also allowed to operate a project subsidiary within a bonded area. In practice, despite how there is no regulatory requirement, there is still a requirement on the minimum amount of registered capital for such single plane or single ship company, ranging from RMB100,000 to RMB300,000

			Permit financial leasing companies to concurrently operate in the business of commercial factoring which is related to its main business	According to the <i>Notice on Work related to the Pilot Project of Commercial Factoring</i> issued by the Ministry of Commerce, investors shall set up an independent company to operate in the business of commercial factoring and no mixed operation is allowed. Commercial factoring companies shall not conduct financial activities such as receiving deposits and issuing loans, nor shall it be specialized in or be authorized to operate in the collection business. From a legal perspective, financial leasing companies are at present not allowed to concurrently operate in the business of commercial factoring
Shipping Services	4.	Ocean Shipping	Relax restrictions on the proportion of foreign shares in Sino-foreign joint venture or cooperative international shipping enterprises, with transport authorities under the State Council to be responsible for working out related administrative measures (trial)	According to the relevant provisions stipulated in the <i>Administrative Rules on Foreign Investment in the International Shipping Industry</i> , foreign investors shall only operate a business of international shipping in the form of EJVs or CJVs and their contribution to the registered capital shall be no more than 49%
			Allow ships without Five-Starred red flags owned or held by Chinese-funded companies to take the lead in trying out the business of carrying import and export containers between coastal ports and Shanghai Port.	Ships of flag of convenience owned or controlled by Chinese investors cannot enjoy the domestic preferential policy. Treatment for such ships is substantially equal to foreign ships
			Implement the international ship registration policy being carried out in Tianjin Port	According to the <i>Pilot Plan on the Innovation of Regulations on the International Ships Registration in Tianjin Dongjiang Bonded Port</i> , the following ships will be subject to International Ships Registration: cargo ships with carrying capacity over 1,600t, irregular passenger ships, drilling platforms and other water shifters, excluding regular passenger ships sailing on international routes. In the event that the registered capital of the ship legal person contains foreign investment, such foreign investment shall account for no less than 50%; enterprises set up by FIEs in Tianjin Dongjiang Bonded Port will be exempted from the aforesaid restriction
	5.	International Ship Management	Allow the establishment of wholly foreign-owned international ship management enterprises	According to the relevant provisions stipulated in the <i>Administrative Rules on Foreign Investment in the International Shipping Industry</i> , foreign investors may operate a business of international ship management only in the form of EJVs or CJVs
Merchandising and	6.	Value-added Telecommunications	On the premise that network and information security is ensured, to allow foreign enterprises to run part value-added telecommunications business	According to the relevant provisions of the <i>Administrative Rules on Foreign Invested Tele-enterprises</i> , contribution percentages made by foreign investors in a foreign investment telecommunications enterprise

Trade Related Services		Services	in a specialized form. Business that is beyond administrative laws and regulations is subject to the State Council's approval	which operates value-added telecommunications services (including wireless paging businesses within the basic telecommunications) shall not exceed 50% and no foreign investment is allowed in the area of internet information services
	7.	Sale and Service of Gaming and Recreational Machines	Allow foreign enterprises to manufacture and sell gaming and recreational equipment, and to allow equipment that passes the content censorship of the cultural authorities to enter the domestic market.	According to the <i>Notice on the Particular Administration Opinions on Setting Up Electronic Gaming Operation Sites</i> , since June 15, 2000, domestic manufacturing and sales of electronic gaming devices as well as its components and parts shall cease and no enterprises or persons may be allowed to conduct domestic-oriented manufacturing and sales of electronic gaming device as well as its components and parts
Professional Services	8.	Lawyer Services	Explore ways and mechanisms for promoting cooperation between Chinese law firms and their counterparts in foreign countries (Hong Kong, Macao and Taiwan).	According to the <i>Mainland and Hong Kong Closer Economic Partnership Arrangement</i> and <i>Mainland and Macao Closer Economic Partnership Arrangement</i> , Hong Kong/Macao law firms (offices) that have set up representative offices in Mainland China may operate in association with Mainland China law firms, except in the form of partnerships. Hong Kong/Macao lawyers participating in such associations may not handle matters of Mainland China law
	9.	Credit Survey Firm	Allow the establishment of foreign-invested credit inquiry companies	According to the Catalogue, the operation of credit survey and rating services companies falls into the "restricted" category for foreign investment
	10.	Outbound Tourism	Any Sino-foreign joint venture travel agency in the FTZ which fulfills the relevant requirements may participate in the outbound (Taiwan excluded) tourism business	According to the <i>Interim Measures for the Supervision and Administration of the Pilot Operation of the Outbound Tourism Business by Sino-foreign Joint Venture Travel Agencies</i> , the quantity of Sino-foreign joint venture travel agencies participating in the pilot programs of the outbound tourism business is under strict control
	11.	Human Resources Consulting Services	For any joint venture job intermediary agency established in the FTZ, the minimum registered capital shall be US\$125,000, and the shareholding percentage of foreign investors shall not exceed 70% (previously, only Hong Kong and Macao service providers could enjoy such policy)	According to the <i>Interim Provisions Concerning the Management of Chinese-foreign Joint Job Intermediary Agencies</i> , a Sino-foreign job intermediary agency shall have a registered capital of no less than US\$300,000 of which, the shareholding percentage of foreign investors shall be no less than 25% and no more than 49%, while the shareholding percentage of Chinese investors shall be no less than 51%
	12.	Investment Management	Allow the establishment of joint-stock foreign-invested holding companies	According to the <i>Provisions on the Establishment of Investment Companies by Foreign Investors</i> , a foreign invested holding company shall be in the form of a limited liability company

	13	Engineering Design	Foreign-invested engineering design (excluding geotechnical investigation) enterprises focusing on Shanghai may disregard engineering design performance requirements on their investors during their first application for qualification	According to the <i>Rules for the Administration of Foreign-funded Construction Engineering Design Enterprises</i> , foreign investors and foreign service providers of a foreign-funded construction engineering design enterprise shall be an enterprise, a certified architect or an certified engineer that are engaged in construction engineering design in their respective countries
	14	Construction Services	When undertaking Sino-foreign joint construction projects, wholly foreign-owned construction enterprises in the FTZ shall be unconstrained by ratios between investments from Chinese and foreign investors of the projects	According to the <i>Rules for the Administration of Foreign-funded Construction Enterprises</i> , a construction enterprise in the form of a WFOE is only allowed to contract, within its scope of qualifications, a joint construction project in which foreign investment occupies no less than 50%, and a Sino-foreign joint construction project in which foreign investment occupies less than 50% but which cannot be independently implemented by any Chinese construction enterprise due to technical difficulties and has been approved by the provincial construction governmental authorities
Cultural Services	15	Performance Brokerage	Lift restrictions on the proportion of shareholding in foreign performance brokerage institutions, and allow the establishment of wholly foreign-owned performance brokerage institutions so as to provide related services in Shanghai	According to the Catalogue, the operation of performance brokerage companies falls into the “restricted” category for foreign investment, which should be majority controlled by the Chinese parties
	16	Entertainment Venues	Allow the establishment of wholly foreign-owned entertainment venues so as to provide related services in the FTZ.	According to the Catalogue, the operation of entertainment venues falls into the “restricted” category for foreign investment, which should be limited to the form of EJV or CJV
Social Services	17	Education and Training	Allow the establishment of Sino-foreign cooperative education training institutions and Sino-foreign cooperative vocational skills training institutions.	<p>According to the Catalogue, although the operation of higher education institutions belongs to the “encouraged” category for foreign investment, it should be limited to the form of EJV or CJV; Ordinary high-school educational institutions fall into the “restricted” category for foreign investment which should be limited to the form of CJV; The operation of compulsory education institutions, special area education institutions such as military, police, political and party schools fall into the “prohibited” category for foreign investment.</p> <p>In practice, most foreign investors make domestic investments through the establishment of Sino-foreign cooperative education institutions,</p>



				running a Sino-foreign cooperative school project or vocational training project, or through the structure of a Viable Interest Entity
	18	Medical Services	Allow the establishment of wholly foreign-owned medical institutions.	According to the Catalogue, operation of medical institutions belongs to the “permitted” category. However, according to the relevant regulations, the proportion of shares or interest of the Chinese party to the Sino-foreign equity joint or cooperative joint medical institution shall be no lower than 30%, but Hong Kong and Macao service providers may establish wholly owned hospitals in all four municipalities and provincial capital cities in Mainland China while Taiwan service providers may establish wholly owned hospitals in Shanghai, Jiangsu, Fujian, Guangdong and Hainan
<i>Note: All the above opening-up measures apply to enterprises incorporated in the Shanghai FTZ only.</i>				

In addition to expanding the scope of openness of the industries above, the FTZ also supports overseas investment in various forms made by investment companies within the FTZ. The FTZ encourages the establishment of project companies which focus their investment on overseas equity investment and supports the capable investors in setting up FOFs overseas equity investments (fund of funds).

What should be noted here is: (i) more detailed measures to be issued by the States Council will clarify the openness of the aforesaid areas; and (ii) how to operate in practice (including the establishment of enterprises within the FTZ and how enterprises within the FTZ conduct business outside the FTZ) will also need to be further put into practice.

## **Promote Transition of Trading Development Mode**

According to the Notice, the FTZ will promote trading transformation and upgrading. The measures mainly include:

- (a) to encourage multinational corporations in establishing Asia-Pacific regional headquarters and operational centers which integrate the functions of trading, logistics, settlement and the like;
- (b) to advance the pilot project of international settlement centers and expand the functions of cross-border receipts and payments and cross-border financing of special accounts for trading and services;
- (c) to support the development of off-shore business operated by enterprises within the FTZ;
- (d) to expand and improve the pilot projects of futures bonded delivery and to expand the function of pledge financing of the warehouse receipts.
- (e) to promote the development of outsourcing business such as biological medicine, software and information, management and consulting and data services;
- (f) to encourage the establishment of third-party inspection and evaluation agencies and accept their testing results in accordance with international standards;
- (g) to carry out pilot projects in the maintenance business of high technology and high additional value;
- (h) to accelerate the cultivation of cross-border E-commerce service functions and to carry out the pilot project of setting up matched supporting systems including Customs supervision, inspection and quarantine, tax rebate, cross-border payment and logistics.

## **Establish Matched Supervision and Tax System**

The Notice request innovation of supervision mode (including the principle of “opening the first line, effectively controlling the second line”) so as to facilitate the free flow of commodity and services as well as other elements within the FTZ.

Meanwhile, the FTZ will implement a series of matched tax policies, which mainly include:

- (a) Enterprises registered in the FTZ or individual shareholders thereof may pay income tax incurred from the value-added part of asset evaluations derived from the rearrangement of assets such as external investment using the non-currency assets by installments within 5 years;
- (b) The tax policy of the payment of individual income tax incurred from equity incentives by installments applied in pilot projects such as Zhongguancun may also be applied to the award granted to enterprises’ high-end personnel and scarce talents by the enterprises within the FTZ in the form of equity by giving shares or contribution ratios;<sup>6</sup>

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<sup>6</sup> According to the *Notice regarding Individual Income Tax incurred from Equity Award within Zhongguancun*,

- (c) Domestic leasing companies and their project subsidiaries registered in the FTZ will enjoy a tax preference of import VAT in case they buy airplanes with a carrying capacity over 25t and then rent such airplanes to domestic airline companies subject to the component authority's approval;
- (d) Products manufactured and processed by enterprises within the FTZ and sold into inner Mainland China through "the second line" shall be levied on import VAT and consumption tax in accordance with the relevant laws and regulations;
- (e) Imported commodities such as machines and equipment which are necessary to manufacturing enterprises and producer service enterprises within the FTZ will be duty-free, with the exception of commodities imported by life service enterprises and commodities which shall not be exempted from duty in accordance with the relevant laws and regulations.

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*Donghu and Zhangjiang National Independent Innovative Demonstration Zone and Hefei-Wuhu-Bengbu Comprehensive Independent Innovation Experimental Area* issued by the State Administration of Taxation and Ministry of Finance, the individual income tax derived from the award granted to enterprises' relevant technicians by enterprises within pilot programs in the form of equity by giving shares or contribution ratios may be paid by installments in no more than 5 years upon the approval of the component tax authority if such technicians have difficulty in paying the tax in a lump sum.

## ● **Important Announcement**

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If you have any questions regarding this publication, please contact **Kelvin Gao**, (+86-21-6080-0920; [kelvin.gao@hankunlaw.com](mailto:kelvin.gao@hankunlaw.com)) or **Shu Wang**, (+86-10-8525-5526; [shu.wang@hankunlaw.com](mailto:shu.wang@hankunlaw.com)).