

China (Shanghai) Pilot Free Trade Zone expanded to the new Lingang area -- a new window to economic globalisation

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In brief

On 6 August 2019, the State Council issued an Overall Plan for the New Lingang Area of the China (Shanghai) Pilot Free Trade Zone¹ (the "Plan") to add the new Lingang area (the "New Area") into the Shanghai pilot free trade zone. According to the Plan, the New Area will match the standard of the most competitive free trade zones globally to facilitate foreign investments and capital flows, as well as the free flow of goods, transportation, employment and information which will build the New Area into a special economic function zone with influence and competitiveness in the global market to spearhead a new round of reform and opening-up in the Yangtze River Delta.

With competitiveness behind the thinking in designing the policies, the Plan is innovative in areas such as preferential tax treatment, convenience in receipt and payment, customs supervision, and investment and operation facilitation. This will bring more opportunities to different sectors in the future. Enterprises should continue to pay attention to any follow-up policies to be issued in the future to align its business models, group structure, investment and financing, personnel arrangement, etc. so as to maximise the benefits brought about by the preferential policies in the New Area.

In detail

Tax policies with international competitiveness

The plan has set forth the following tax policies:

1. Corporate income tax (CIT) at the rate of 15%: Qualified enterprises engaged in critical-process manufacturing and R&D in the sectors of integrated circuits, artificial intelligence, biomedicine and civil aviation and etc., are eligible for a reduced CIT rate of 15% for 5 years commencing from the year of establishment.

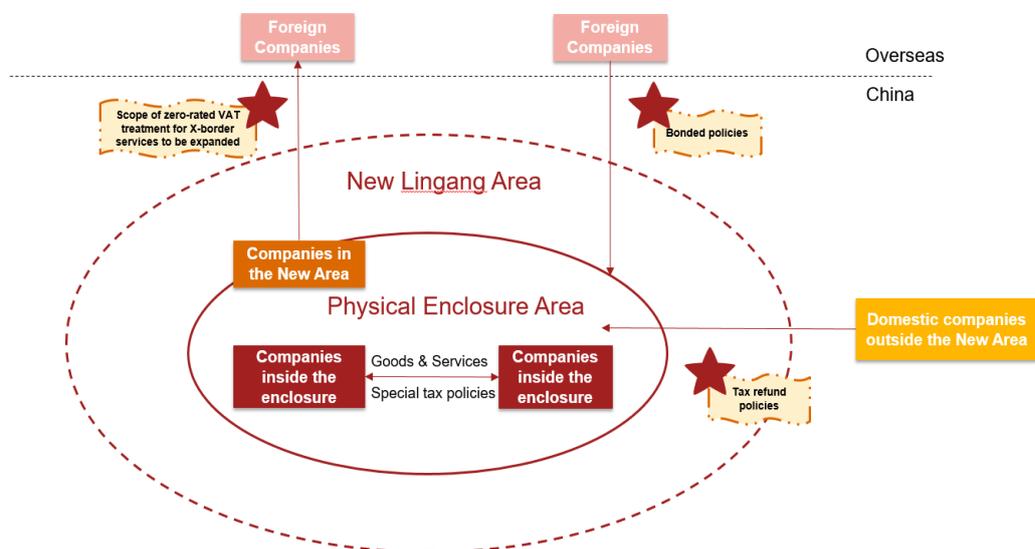
Before the issue of above policy, the 15% CIT preferential tax rate are limited to high and new technology enterprises (HNTE), technology-advanced and service enterprises (TASE), integrated circuits manufacturing enterprises, enterprises engaging in pollution prevention and control, and enterprises in encouraging industries in State supported regions (e.g., the Western Regions, Hengqin New Area, Qianhai, Pingtan, etc.). In particular, for enterprises wishing to enjoy the HNTE or TASE preferential CIT rate, they have to meet certain prescribed thresholds and do a lot of preparatory work in order to obtain the required accreditation. Whereas the Plan has remarkably expanded the scope of enterprises eligible for the preferential tax rate in specific sectors across the free trade zone, which will contribute to fostering and developing advanced technologies to form a business cluster and drive the development of relevant areas. It is worth mentioning that attention shall be paid to the release of the relevant rules for the implementation of the above tax policy, including how to determine whether an enterprise falls into the above industries, whether there is any requirement on the ratio of relevant income, any other requirements on production function or R&D expenditures of an enterprise, etc., in order to qualify for the preferential tax rate.

2. Tax subsidies for overseas talents: Policies on subsidizing overseas talents' individual income taxes will be explored based on experience obtained from trial practice in other areas.

Such policies are designed to attract high-end talents. It is expected that the subsidy policies on individual income tax (such as talent recognition and subsidy measures) to be implemented may possibly refer to the practice in the 9 cities in Guangdong-Hong Kong-Macao Greater Bay Area. Given the fact that the subsidies are to be provided by the local government, it remains to be seen how the final subsidy policies for individual income tax in Shanghai will compare those in the Greater Bay Area.

3. Special tax policies in the physical enclosure area: Foreign goods entering into the physical enclosure area, as well as goods and services traded among enterprises in the physical enclosure area are subject to special tax policies.

More specifically, 1) it is likely that tax policies in the existing special areas may be applied to the physical enclosure area, under which goods are bonded or subject to tax refund; 2) goods traded among enterprises in the physical enclosure area may possibly follow the current tax exemption policy for goods traded among enterprises in the existing special areas; 3) special preferential tax policies may be released for services provided among enterprises in the physical enclosure area. This coincides with what we have expected at the beginning of the year regarding policy innovation for areas under special supervision of the customs.



4. Value-added tax ("VAT") policies on service export: Eligible scope of VAT policies on service export in the New Area is to be expanded.

It is highly likely that the zero-rated VAT treatment for export services provided by enterprises in the New Area may be further expanded. Considering the proposed functions and positions of the New Area, we believe that financial services which are closely related to the opening up and innovation of the financial sector are more likely to benefit from such policies.

In addition to above policies, the Plan also states that the government will study tax policies for the New Area to support the development of overseas investments and offshore businesses, and explore tax policies in terms of investment and financing activities and financial businesses via free trade accounts, as long as they do not result in tax base erosion and profit shifting. Currently, tax policies regarding cross-border investments and offshore businesses are not clearly defined, therefore, any breakthroughs in the New Area will provide strong support for Shanghai to develop headquarters economy and become a model in replicating such policies in other cities.

Cross-border financial management system facilitating receipt and payment

The New Area will implement, on a trial basis, financial policies featuring more openness, more convenience and higher liberalisation. In order to achieve a high-level financial openness and innovation, the New Area strives to push forward measures in this area, enhance the facilitation of trades and investments, and improve the legal environment in the financial sector, including:

1. Further streamlining cross-border RMB business processes for premium quality enterprises to promote the facilitation of cross-border financial services;
2. Piloting RMB convertibility under free trade accounts to explore the liberalisation of capital flows and currency convertibility in the New Area;
3. Supporting enterprises in the New Area to carry out cross-border financial activities by reference to international practices and in accordance with the existing rules and regulations, and financial institutions to provide cross-border

financial services for enterprises in the New Area and non-residents, such as cross-border bond issuance, cross-border investment and M&A and cross-border capital pooling operation. Enterprises in the New Area are allowed to use funds raised overseas, and qualified financial institutions are allowed to use funds raised overseas and revenue received from rendering of cross-border services for operation and investment activities inside or outside the New Area;

4. Encouraging qualified financial institutions to engage in cross-border securities investment, cross-border insurance asset management, etc.;
5. Steadily promoting the convertibility of capital items in accordance with the State principles of coordinated planning, serving the real economy, controlling risks and advancing step-by-step;
6. Taking the financial sector as a pilot in opening-up, actively implementing measures such as relaxing foreign ownership limits on financial institutions, expanding the business scope of foreign-funded financial institutions, and supporting qualified foreign investors to establish various financial institutions in accordance with relevant laws to ensure a level playing field for both Chinese and foreign financial institutions.

We notice that the orderly promotion of the above-mentioned measures of financial opening-up and innovation are in line with the “11 measures”² recently issued by the Office of the Financial Stability and Development Committee under the State Council. It may also indicate the general tone of the country to pilot these financial opening up measures in the New Area to build Shanghai into an international financial centre. The implementation of the above policies may provide a higher level of support for overseas investments, cross-border M&A, and freer use of corporate working capital. Going forward, we believe that a series of detailed rules will be issued to improve the relevant supporting arrangements (such as a wider opening up of free trade accounts) to provide guidance for the implementation of those innovative initiatives in the New Area.

Fair, open and convenient environment for investment and operation

The Law on Wholly Foreign-Owned Enterprises provides a legal basis for implementing experimental policies and measures on foreign investments and a higher level of opening-up in the pilot free trade zone. The *Special Administrative Measures for Foreign Investment in the Pilot Free Trade Zones* (PFTZ) (the Negative List³) is applicable in the New Area, and, combining with the positioning of the New Area, the next step will be to 1) enhance the opening up effort in key sectors such as telecommunications, insurance, securities, scientific research and technical services, education and health; 2) strengthen the development a judicial organisation for international commercial disputes, which would contribute to a better environment for attracting foreign investments and expanding opening up.

Encouraging cross-border RMB financial services

The Plan encourages enhancing capabilities regarding RMB cross-border financial services to expand the depth and breadth of the services, including cross-border RMB trade finance and refinance, and encourages global companies to establish their global or regional fund management centres in the New Area. It aims to further promote the internationalisation of the RMB and the development of the global or regional fund management centres, which fully reflects the decision-makers' vision of benchmarking it against the most competitive free trade zones in the world. Therefore, it can be expected that relevant authorities will introduce detailed fiscal and tax support policies for cross-border financial and fund management business in the near future to substantially enhance the New Area's competitiveness in the global market.

Establishing Yangshan bonded port area

Yangshan bonded port area will be established in the New Area as a new type of special customs supervision area. It will explore and implement regulatory policies that can provide a higher level of trade liberalisation and facilitation to improve the efficiency of port supervision, and enhance its functions as a hub for international transit and LCL business. This will further materialize trade liberalisation and facilitate the integrated development of the domestic and foreign markets. It will fully implement relevant policies stipulated for the comprehensive bonded zone and eliminate unnecessary trade regulations, licensing and procedures. In addition, as Customs will strengthen the classification management on enterprises, it can be expected that the “Compliance and Facilitation” principle will be widely applied and credit rating will serve as a key basis for enterprises to enjoy preferential policies and systems. The voluntary disclosure system and the dishonest list will continue to apply among other systems. Relevant regulatory policies will be formulated separately as led by the General Administration of Customs.

Synergy innovation and development of the Yangtze River Delta

The Plan encourages domestic and foreign investors to jointly set up innovation special funds in the New Area, and cooperate on major scientific research projects. Relevant funds can be used freely within the Yangtze River Delta region. It also allows overseas private funds initiated by domestic investors to finance technological innovation-based enterprises in the New Area and invest in the Yangtze River Delta region when certain requirements are met. It encourages the New Area to expand its competitive industries to the Yangtze River Delta region to form an industrial cluster. Pilot implementations in the New Area will mobilise the integrated and coordinated development of the Yangtze River Delta region.

The takeaway

The Plan is seen as the advancement and implementation of the nation's major strategic deployment towards a comprehensive and high-level opening-up, reflecting a comprehensive innovation and transformation brought by various new policies and systems in the China Pilot Free Trade Zone. It leads to an economic ecology with a higher level of freedom and convenience for the integrated development of trade, investment, finance, shipping, science and technology among others.

According to the press conference held by the State Council Information Office on 6 August, we learned that the New Area would be given greater freedom in the transformation, and there may be further breakthroughs and innovations in tax policies. The New Area would also be given priority in the future for the implementation and universal application of new policies. Enterprises in the New Area will benefit from the pilot implementation of new policies. For example, regarding investment and financing, tax policies, international trade, etc., key developed industries such as integrated circuits, biomedicine, artificial intelligence, and aviation and aerospace will embrace an integrated development, and acceleration in transformation and upgrading.

Currently, Shanghai has completed preparations of management measures, special supporting policies, and government service programs for the New Area. The New Area will be a pilot area in implementing major reform measures and projects that are in line with its positioning. A series of specific plans will be introduced, such as policies regarding corporate income tax in key sectors and implementation plans for special bonded areas managed by the customs. Based on policy structure of the Plan and its own situation, an enterprise can adjust its operating model, group structure, investment and financing, personnel arrangement etc., to maximise the benefits brought about by the favourable policies in the New Area. Particularly for high-tech companies conducting R&D and production activities, they may re-consider the factory location, supply chain arrangement, cross-border trade, etc.

Endnote

1. Notice Issued by the State Council Releasing the <General Plan of Lingang New Area in China (Shanghai) Pilot Free Trade Zone> (Circular Guofa [2019] No. 15)
http://www.gov.cn/zhengce/content/2019-08/06/content_5419154.htm
2. Relevant Measures for Further Opening up the Financial Industry Announced by the Office of the Financial Stability and Development Committee under the State Council
<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3863019/index.html>
3. Please refer to our [News Flash \[2019\] Issue 21](#) for more details.



Let's talk

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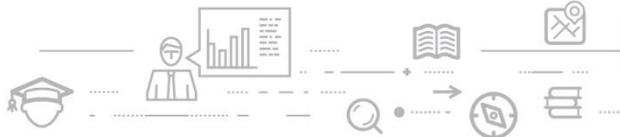
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