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Trading in China – a breakthrough for trading companies in the FTZ (“Free Trade Zones”)

Following China’s accession to the WTO, steps to open up its market by the Chinese authorities have become apparent and trading companies in the FTZs are among the first to benefit. The State Administration of Industry and Commerce (“SAIC”) recently issued a notice to remove the restriction on trading companies in FTZs to establish offices outside their FTZ. This provides an opportunity for foreign importers to extend their distribution force in China.

The Interim Solution offered in the FTZ

According to the Chinese rules, foreign companies are not allowed to engage in trading activities in China. The FTZs, however, offer some sort of interim solution for foreign importers. In light of the special import mechanism used in the FTZs, the most developed one being in Shanghai (the Waigaoqiao FTZ), foreign importers can bring goods into China through their wholly owned trading companies in the FTZs. The activities of these trading companies are, however, limited. Prior to the new SAIC notice, the FTZ trading companies were not allowed to establish offices outside the FTZs where the customers are primarily located. The trading companies were usually structured as invoicing agents or pass-through entities.

Although the trading companies have facilitated import trades with their capacity to collect Renminbi locally and issue VAT

invoices, the current business structure is inadequate. Many of the trading companies find it difficult to operate purely as a pass-through. To compete effectively, it is crucial to operate using their own people or sales representatives on the ground. Given the limitation to operate in the mainland, the questions of how these people are to be employed and where they should be located have remained unresolved for many FTZ trading companies.

New Business Model

With the new SAIC relaxation, these concerns can be erased. Trading companies can now set up their offices and hire their own people throughout the country. As a result, the trading companies are much closer to their customers. Essentially, goods can be distributed through the trading companies’ own sales force over China.

Having said that, the trading companies are still far from being a true distributor. The offices that are allowed are still limited to “liaison” offices rather the “branch” offices. Liaison offices are not allowed to carry out sales; rather they act as a liaison for business on behalf of its parent trading company at the FTZ.

Going Forward

We feel that China will continue to open up to fulfil its commitment to the WTO. The way will be gradual and the relaxation of SAIC is an indicative step. It is expected that opportunities to access the China market will be on the rise.

This publication is prepared for clients of PricewaterhouseCoopers and others interested in our services. Comments are not intended to be comprehensive and detailed advice should be obtained by contacting a partner or director listed below. Additionally, we welcome you to visit our PricewaterhouseCoopers China website at <http://www.pwcglobal.com/cn> for practical insights and professional solutions to current and emerging business issues.

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