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RSM Tax Advisory (Hong Kong) Limited

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INNOVATIVE TAX INCENTIVES FOR HAINAN FREE TRADE PORT IN CHINA

During the recent months, various interpretation rules have been announced by the China authorities in relation to the innovative tax policies for qualifying enterprises (including certain non-resident enterprises) and individuals working in Hainan Free Trade Port (“Hainan” or “the FTP”). In this Tax Flash, we will provide the salient points of the FTP plan and the related key tax incentives.

ABOUT HAINAN

- Hainan is an island province at the southernmost of China with land area of 35,400 km², sea area of about 2 million km² and a population of more than 9.4 million.
- It is a maritime gateway between the Indian Ocean and the Pacific Ocean, and a regional center connecting Northeast Asia and Southeast Asia, including Vietnam, Malaysia, Philippines and Brunei Darussalam of ASEAN.
- Hainan is an internationally renowned tourist hotspot with beaches, tropical fruits, various natural resources and duty-free shopping.
- International events such as The Boao Forum for Asia, Asian Beach Games, etc. have been regularly held in Hainan.
- On 23 July 2020, China launched the first Mars mission at Wenchang Space Launch Center located in Hainan. Further satellite launching plans for the coming years have been scheduled.
- On 30 July 2020, the second phase of the expansion project of Haikou Meilan International Airport in Hainan started test flight.
- High-Speed Rail networks are being built to link up Haikou city of Hainan and Guangzhou city of the Greater Bay Area. (Hainan used to be an administrative district of Guangdong Province and was spun off by the central government in 1988.)
- Hainan has been designated one of the five Special Economic Zones of China since April 1988 and has been the largest one. Hainan is now developing into an internationally competitive Free Trade Port like those in Hong Kong, Singapore and Dubai.

STATE COUNCIL'S OVERALL PLAN FOR HAINAN FREE TRADE PORT

- Progressive liberalization and facilitation on six areas:
 - ✓ Trade (goods and services)
 - ✓ Investment (expanded market access)
 - ✓ Cross-border fund flows (especially capital account items)
 - ✓ People (competitive talent policies)
 - ✓ Transportation (western land-sea corridor and international hubs)
 - ✓ Secure and orderly flow of data (opening-up data sectors and developing digital commerce)
- Key milestones of the FTP plan:
 - ✓ Completion of foundation stage before year 2025
 - ✓ Rolling out of comprehensive import tariff bonded/exempt treatments to the entire FTP by year 2025
 - ✓ Achievement of maturity stage before year 2035
 - ✓ Becoming a globally significant Free Trade Port by the middle of this century

MOST SUITABLE INVESTMENTS

- Three major service sectors:
 - ✓ Tourism
 - ✓ Modern services
 - ✓ High-tech industries
- Project industries include agriculture, shipping, telecommunications, business and professional services, finance, medical treatments, education, culture, sports, etc.
- Outbound investment hub of China, especially for investments in tourism, modern services and high-tech projects overseas.

MODERN TAX SYSTEM & INCENTIVES

Guiding principles of a tax system for the internationally competitive and high standard FTP:

- Zero import tariff
- Low tax rates
- Simplified system
- Strong governance of taxpayers and tax authorities

ENTERPRISE INCOME TAX ("EIT") INCENTIVES

- From 1 January 2020 to 31 December 2024:
 - ✓ For enterprises registered and engage in encouraged industries in the FTP, their EIT rate is reduced to 15% on Hainan-source income.
 - ✓ Non-resident enterprises with Permanent Establishment ("PE") in Hainan carrying on encouraged industries are also subject to EIT at a reduced rate of 15% on Hainan-source income.
 - ✓ Qualified capital expenditure on newly acquired fixed assets (except for building and construction) can be fully deductible in the current period or deducted through accelerated tax depreciation/amortization over the years.
 - ✓ For tourism, modern service or high-tech industry enterprises established in Hainan, their dividend income/profits derive from new direct investment overseas (including capital increase of existing overseas companies or acquisition of ownership of overseas companies) are exempted from EIT.
- To be introduced by 2035:
 - ✓ The 15% preferential tax rate will be rolled out to virtually all enterprises registered and operate in Hainan (except for those industries on the Negative List (e.g. prohibited projects)).

INDIVIDUAL INCOME TAX ("IIT") INCENTIVES

- From 1 January 2020 to 31 December 2024:
 - ✓ For eligible talents working in the FTP, their actual IIT burden on eligible income is capped at 15%.
 - ✓ The list of covered talents and qualification requirements have been formulated and will be announced soon.
- To be introduced by 2035:
 - ✓ For individuals who have resided in Hainan for 183 days or more in aggregate in a tax year, their eligible income will be subject to progressive tax rates at 3%, 10% and 15% only.
- The IIT incentive is not only applicable to foreigners but also mainland Chinese talents.

- Eligible income means Hainan-source comprehensive income and operating income. Dividends, capital gains, etc. are not included.
- It is a tax exemption incentive (by way of tax refund upon annual IIT filing) rather than a financial subsidy which has been used in the mainland cities of the Greater Bay Area.

TURNOVER TAX INCENTIVES

- To be introduced by 2025 (completion of the foundation stage):
 - ✓ Value-Added Tax (“VAT”), Consumption Tax (“CT”), Vehicle Purchase Tax, Urban Maintenance and Construction Tax and Education Surcharges will be combined into a composite sales tax and levied at “retail stage” of goods and services.

IMPORT TARIFF INCENTIVES

- Currently in Yangpu Bonded Port (“YBP”) of Hainan:
 - ✓ For the goods produced by encouraged industrial enterprises that (i) do not contain imported materials; or (ii) the imported contents are processed in the YBP with added-value of more than 30%, import customs duty is exempted when the products are sold to non-YBP buyers in China.
 - ✓ For goods entering and leaving between the YBP and overseas, companies do not need to perform customs declaration, except for goods that require quarantine inspection or permit verification. The goods are under bonded treatment.
 - ✓ Enterprises in the YBP can carry out operations such as transfer and compilation, processing and manufacturing, trading, research and development, re-manufacturing, inspection and maintenance, etc. Their business activities do not need to go through customs procedures, and there is no storage period limit for bonded goods in the YBP.

- “Zero-tariff” on 4 categories of goods in the FTP before 2025:

- ✓ The eligible goods can be imported into Hainan from overseas with imported customs duty and import taxes (VAT and CT) exempted.
- ✓ The four lists of goods are:
 - A Negative List of production equipment for own use of enterprises in Hainan.
 - A Positive List of ships, aircrafts and other vehicles used for transportation and tourism in Hainan as well as yachts.
 - A Positive List of raw materials and auxiliary materials consumed in Hainan for own production or for export processing.
 - A Positive List of consumer goods imported for consumption by the residents in Hainan, and the residents can purchase them tariff-free.
- ✓ The lists of goods and implementation rules are being formulated and will be announced soon.

- Tourists’ tariff-free retail shopping in Hainan:
 - ✓ Effective 1 July 2020, the tariff-free shopping limit has been increased from RMB30,000 to RMB100,000 per visitor per year.
 - ✓ Import customs duty and import taxes (VAT and CT) are exempted on the designated consumer goods.
 - ✓ Designated consumer goods have been increased from 38 to 45 categories.
 - ✓ Tourists refer to foreigners and mainland Chinese (including Hainan residents) who are above the age of 16 and leaving Hainan Islands but not leaving overseas.
- To be rolled out to entire FTP from 2025:
 - ✓ Except for limited items on the list of dutiable goods, all goods imported into Hainan will be exempted from import customs duty.

POINTS TO NOTE

Hainan Free Trade Port is a strategic and comprehensive location for international investments in addition to the Guangdong-Hong Kong-Macao Greater Bay Area, the proximity platforms for ASEAN market and the Belt and Road investments.

To attract domestics and international investors and talents to participate in the FTP development, both EIT and IIT is generally capped at 15% on Hainan-source income of qualified taxpayers:

- It is a breakthrough for the PE of non-resident enterprises to enjoy the reduced EIT rate of 15% on the Hainan operating income.
- On top of the FTP incentives, for New and High Technology Enterprises newly incorporated in a Special Economic Zone (including Hainan Special Economic Zone), they can enjoy “2+3 tax holiday” (i.e. full tax exemption for the first two years since its first revenue making year and be taxed at reduced tax rate of 12.5% for the subsequent three years).
- In other locations, IIT incentives are usually by way of annual financial subsidies and only cover foreigners. In Hainan; however, a more certain and consistent IIT exemption incentive is offered and is open to both overseas and mainland Chinese talents. That will certainly be welcomed by individual taxpayers. However, it would be even better if the IIT could be exempted on a monthly basis rather than application for tax refund upon filing of annual IIT returns.

- Although it is not explicitly mentioned in exiting tax notices, it seems that candidates may need to physically work in Hainan for at least 183 days in aggregate in a tax year in order to secure the IIT exemption. For executives in service industries, they are usually required to travel extensively to different cities or abroad, and it may be a challenge for them to work/stay in Hainan for half year in total. Hope the specific requirements and details will be announced soon to clarify.
- “Zero-tariff” policy will save a lot of upfront cash of the importers, and the living costs in Hainan. Processing/production in YBP will help to reduce import costs and improve sales and profit margin of the processing/production company.
- According to the Customs statistics, as of 31 December 2019, the tariff-free retail shopping malls in Hainan has attracted a total of 16.31 million shoppers and tariff-free sales were RMB53.8 billion. Hainan will continue attracting international companies in tourism, import trading and related sectors.

If you would like to have further information, please contact us.

RSM Tax Advisory (Hong Kong) Limited

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- Advise on tax efficient holding and operational structures for new cross-border investment, including the formation of Hong Kong and Chinese business entities
- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

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