

JUNHE SPECIAL REPORT



July 8, 2020

Official Launch of Preferential Tax Policies for the Hainan Free Trade Port

Introduction

Recently, the Ministry of Finance ("MOF"), the General Administration of Customs ("GAC") and the State Administration of Taxation ("SAT") released three circulars to implement the tax policies introduced by the Overall Plan for the Construction of the Hainan Free Trade Port (the "Overall Plan") issued by the Central Committee of the Communist Party of China and the State Council, including the "Preferential Corporate Income Tax Treatment", "Preferential Individual Income Tax Treatment" and "Duty-free Shopping Policies". We summarize the salient points of the relevant circulars for the reader's reference and assessment for eligibility.

I. Policy Overview

According to the Overall Plan, the Hainan Free Trade Port provides the following preferential tax policies:

Preferential Corporate Income Tax Treatment

"... An enterprise in encouraged industries that is registered and operating substantively at the Hainan Free Trade Port is entitled to a preferential corporate income tax rate of 15%. Corporate income tax shall be exempted for

income derived by enterprises in the tourism, modern service and high-tech industries established at the Hainan Free Trade Port for newly-added overseas direct investments before 2025. For eligible capital expenditures of enterprises, a one-off pre-tax deduction or accelerated depreciation and amortization method may be allowed in the current period when such expenditures are incurred."

Preferential Individual Income Tax Treatment

"... for high-end and urgently-in demand professionals working at the Hainan Free Trade Port, the portion of their actual individual income tax burden exceeding 15% shall be exempted."

Duty-free Shopping Policies

"... extending the outgoing duty-free shopping quota to CNY100,000 per person per year and expanding the varieties of duty-free commodities."

The documents recently issued by MOF, GAC and SAT are for the implementation of the above tax related policy. The specific circulars and corresponding applicable period are as follows:

Tax policy	Implementation Documents and Applicable Policy Period
Preferential Corporate Income Tax Treatment	Notice on Corporate Income Tax Preferential Policies for Hainan Free Trade Port (Cai Shui [2020] No. 31), effective from 1 January 2020 to 31 December 2024

Preferential Individual Income Tax Treatment	Notice on Individual Income Tax Policies for High-end Professionals in Shortage at the Hainan Free Trade Port (Cai Shui [2020] No. 32), effective from 1 January 2020 to 31 December 2024
Duty-free Shopping Policies	Announcement on Duty-free Shopping Policies for Tourists Leaving Hainan Island (Ministry of Finance, General Administration of Customs and State Administration of Taxation Announcement [2020] No. 33), effective from July 1 2020

II. Preferential Corporate Income Tax Treatment

Scope of Application	Major Policy Content	Relevant Conditions and Interpretation
Enterprises in Encouraged industries that are registered and carry out substantial operations within the Hainan Free Trade Port	Corporate income tax rate at 15%	<p>For the enterprises in the encouraged industries:</p> <p>An enterprises' main business falls within the scope of the encouraged industries prescribed in the Catalogue of Encouraged Industries in the Hainan Free Trade and the revenue from their main operation revenue accounts for more than 60% of their total revenue.</p> <p>Substantial Operations:</p> <p>This means that the actual management organisation of the enterprise is established at the Hainan Free Trade Port, and implements substantive and comprehensive management and control over the enterprise's manufacturing and business operations, staff, accounts, properties etc.</p> <p>Catalogue of Encouraged Industries in the Hainan Free Trade Port</p> <p>The aforesaid Catalogue includes the Guiding Catalogue for Industrial Structure Adjustments (2019 Version), the Catalogue of Encouraged Foreign-invested Industries (2019 Version) and the Catalogue of Encouraged Industries Newly Added in the Hainan Free Trade Port.¹²</p> <p>Head Office/Branches:</p> <p>For qualified enterprises whose head offices are set up in the Hainan Free Trade Port, only the income of their head offices and branches set up in the Hainan Free Trade Port will be</p>

¹ http://www.gov.cn/xinwen/2019-11/06/content_5449193.htm

² http://www.gov.cn/xinwen/2019-06/30/content_5404701.htm

		subject to the 15% tax rate; for enterprises whose head offices are set up in areas other than the Hainan Free Trade Port, only the income of their qualified branches set up in the Hainan Free Trade Port will be subject to the 15% tax rate.
Tourism, modern service industries and high-tech enterprises established within the Hainan Free Trade Port	Income derived from new overseas direct investments shall be exempt from corporate income tax.	<p>The newly increased overseas direct investment incomes:</p> <p>The following conditions shall be met: 1. The business profits obtained from a newly established overseas branch or the dividend income corresponding to the newly increased overseas direct investment obtained from an overseas subsidiary in which more than 20% (inclusive) of the equity is held; and 2. The statutory corporate income tax rate of the invested country (region) shall not be less than 5%.</p> <p>Tourism, modern service industries, high-tech industries:</p> <p>The Catalogue of Encouraged Industries in Hainan Free Trade Port applies.</p>
Enterprises established within the Hainan Free Trade Port	The newly purchased fixed assets or intangible assets are allowed to be included in the costs and expenses of the current period as a one-off deduction and be deducted in the calculation of the taxable income, or the period of depreciation or amortization may be shortened or the method of accelerated depreciation	<p>Unit value of not more than CNY5 million (inclusive):</p> <p>A one-off deduction in the computation of the taxable income amount shall be allowed.</p> <p>Unit value exceeds CNY5 million:</p> <p>A method of shortening the depreciation or amortization period or accelerating depreciation or amortization may be adopted.</p> <p>Fixed Assets:</p> <p>This refers to fixed assets other than houses and buildings.</p>

	or amortization may be adopted.	
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JunHe's Special Comments:

Prior to the promulgation of the policy, the preferential corporate income tax policies based on regional factors mainly included the preferential corporate income tax rate of 15% for enterprises in encouraged industries located in certain western development areas, Hengqin Guangdong, Pingtan Fujian, Qianhai Shenzhen and Lingang New Area of the Shanghai Free Trade Zone. The launch of preferential tax policies in Hainan, from a tax perspective, provides a new option for domestic and foreign investors.

It is noteworthy that both the Overall Plan and the follow-up implementation documents emphasize the condition of "substantive operations." We understand that this condition is set up to avoid an event whereby a large number of shell companies are registered in order to obtain local tax preferences. Therefore, we suggest that investors comprehensively evaluate the

feasibility and necessity of establishing enterprises in Hainan from perspectives such as markets, operations, staffing, assets, etc., in addition to the consideration of the preferential tax policies.

III. Preferential Individual Income Tax Treatment

Scope of Application	Major Policy Content	Relevant Conditions and Interpretation
High-end professionals and professionals in short supply working within the Hainan Free Trade Port	The part of the actual individual income tax burdens in excess of 15% shall be exempt.	<p>Applicable Income:</p> <p>Comprehensive income (including wages and salaries, remuneration for personal services, author's remuneration, and royalties), operating income, and talent subsidy income recognized by Hainan Province;</p> <p>Filing procedures:</p> <p>Taxpayers shall enjoy the aforesaid preferential policies by performing annual individual income tax filing in Hainan Province.</p>

		<p>Applicable Personnel:</p> <p>A list of high-end professional and talented individuals in short supply who enjoy the aforesaid preferential policies shall be adopted for administration. The detailed administrative measures shall be formulated by Hainan Province in consultation with MOF and SAT.</p>
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JunHe's Special Comments:

This policy is similar to the preferential individual income tax policy granted to the Guangdong-Hong Kong-Macao Greater Bay Area. The difference is that the preferential policy for the Guangdong-Hong Kong-Macao Greater Bay Area is to give financial subsidies based on the difference between the actual individual income tax burden of the mainland and that of Hong Kong (which is determined to be 15% in the follow-up policy), and the subsidies are exempted from individual income tax; while the

preferential policy for Hainan is to exempt the part of the actual tax burden that exceeds 15%.

In order to enjoy the policy, relevant persons are recommended to pay close attention to the subsequent specific administrative measures to be formulated by Hainan Province in consultation with MOF and SAT.

IV. Duty-free Shopping Policies

Scope of Application	Major Policy Content	Relevant Conditions and Interpretation
Passengers departing by plane, train and ship (excluding those departing from mainland China)	Leaving-island Duty-free (exemption of duties, import VAT and consumption tax) shall apply to commodities of limited value, limited quantity and limited varieties purchased.	<p>Qualified Passengers:</p> <p>Domestic and foreign tourists, including residents of Hainan Province, who are 16 years or older and have purchased air tickets, train or ship tickets to leave Hainan, and hold valid identity certificates (identity certificates for domestic tourists, travel certificates for tourists from Hong Kong, Macao and Taiwan, and passports for foreign tourists), leave Hainan but do not leave mainland China.</p> <p>Amount of Duty-free Shopping:</p> <p>RMB 100,000, for an unlimited number of times.</p> <p>Duty-free Shops:</p> <p>Duty-free shops which qualify to implement leaving-island duty-free policies and operate on the basis of franchising. As of this announcement, this includes</p>

		<p>Haikou Meilan Airport Duty Free Shop, Haikou Sun Moon Square Duty-Free Shop, Qionghai Boao Duty Free Shop and Sanya Haitang Bay Duty Free Shop.</p> <p>Restrictions on Commodities and Purchase Quantities:</p> <p>The types of duty-free commodities and the restrictions on the quantity of each purchase shall be subject to the Appendix of the circular³. Any amount exceeding the duty-free quota and limit shall be levied import duties in accordance with the regulations.</p> <p>Penalty:</p> <p>Individuals who violate the provisions of this announcement in reselling, purchasing on behalf of another or smuggling duty-free goods shall be included in the creditworthiness records pursuant to the laws and regulations, and shall not be able to purchase duty-free goods on departure for three years; persons whose act constitutes smuggling or a violation of Customs regulatory provisions shall be dealt with by the customs pursuant to the relevant provisions; where a case constitutes a criminal offence, criminal liability shall be pursued in accordance with the law.</p> <p>The industrial comprehensive rectification shall be carried out on travel agencies and transportation enterprises that assist in violating departure duty-free policies and disturbing the market order.</p> <p>Departure duty-free shops which sell duty-free commodities in violation of the relevant provisions shall be punished by the customs in accordance with the relevant laws and administrative regulations.</p>
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³ <http://gss.mof.gov.cn/gzdt/zhengcefabu/202006/P020200629675745632529.pdf>

JunHe's Special Comments:

The first two policies are targeted to promote the development and construction of the Hainan Free Trade Port from the perspective of investment, while this tax related policy provides support from the perspective of consumption. In

view of the current COVID-19 pandemic and its impact on domestic residents' short-term and medium-term travel plans, we believe that this policy will effectively promote the development of tourism and other related industries in Hainan.

Conclusion

The three documents issued by MOF, GAC and SAT implement the special tax arrangements in the Overall Plan, and support and promote the development and construction of the Hainan Free Trade Port from an investment and consumption perspective. Investors are advised

to assess the potential implications of the policy in light of their own business plans and pay close attention to any further implementation rules to be promulgated by the relevant departments and local governments.

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