



Hainan Free Trade Port – Innovative income tax policies

Summary:

Following the 1 June 2020 issuance of the Overall Plan for the Construction of Hainan Free Trade Port (Hainan FTP Plan), the Chinese Ministry of Finance (MOF) and State Taxation Administration (STA) on 30 June 2020 set out detailed corporate income tax (CIT) and individual income tax (IIT) preferential policies for Hainan FTP. Businesses may find these tax rate reductions and administrative simplifications very attractive in deciding whether to establish Hainan operations.

KPMG observations



The Hainan FTP Plan outlined a range of innovative tax policies, many going well beyond those on offer in China's existing pilot free trade zones. MOF and STA Circular CaiShui [2020] No. 31 and CaiShui [2020] No. 32 have now given concrete detail on these measures.

FTP Plan measure	Detailed rules	KPMG observations
➤ Implementation before 2025		
CIT	CaiShui [2020] No. 31	
<ul style="list-style-type: none"> A reduced 15% CIT (China standard rate is 25%) rate applies to enterprises (i) registered in Hainan FTP; (ii) engaged in substantive business activities; (iii) in encouraged industries 	<ul style="list-style-type: none"> Circular 31 requires establishment of the enterprise's management body in Hainan FTP This must exercise substantive management and control over business operations, staff, accounting, assets, etc. "Encouraged industries" refers to sectors listed in the Guiding Catalogue for Industrial Structure Adjustment (2019 Edition), the Catalogue of Encouraged Industries for Foreign Investment (2019 Edition) and a new Hainan-specific list Enterprise revenue from "encouraged industry" business must be at least 60% of the total 15% tax rate applies to income of head offices and branches set up in Hainan FTP 	<ul style="list-style-type: none"> While yet to be clarified, it is anticipated that the 'substantive management' requirement may be fairly robust. The requirements may draw on domestic anti-avoidance and TP rules, as well as BEPS concepts This could require the enterprise to have functions, including decision-making capacity, commensurate with profitability. It could also require organisational resources, premises and personnel commensurate with enterprise functions The Hainan-specific list is expected to include various sectors within tourism, modern services, and high-tech industries
<ul style="list-style-type: none"> CIT exemption for "new" foreign-sourced income received by Hainan FTP enterprises in the tourism, modern services and high-tech industries 	<ul style="list-style-type: none"> New foreign-sourced income refers to: <ul style="list-style-type: none"> Operating profits earned by newly established overseas branches of the Hainan company; or Dividends repatriated from an overseas subsidiary in which the Hainan company has a shareholding of at least 20%. The dividends must arise from new direct investment made in the overseas subsidiary The statutory CIT rate of the investee jurisdiction must not be lower than 5% 	<ul style="list-style-type: none"> Exemption does not cover asset transfer gains Calculation for exempt dividends yet to be clarified As subsidiaries in zero tax offshore jurisdictions (e.g. Cayman, BVI) do not qualify this has implications for structuring China outbound investment As China-to-China dividend payments are exempt, this may open a path for China MNE parent companies to use the foreign source dividend exemption by structuring foreign holdings via Hainan. Remains to be confirmed The exemption, limited to 2024 under Circular 31, is expected to be extended
<ul style="list-style-type: none"> 100% expensing, and accelerated depreciation regimes for eligible capital expenditure 	<ul style="list-style-type: none"> Applies for newly purchased fixed assets (except for immovables) and intangible assets No limitations on industry or based on usage of assets. 100% expensing only for assets with a unit value less than RMB 5 million 	<ul style="list-style-type: none"> Buildings excluded from scope of fixed assets Intangible assets yet to be defined for the purposes of the relief

CaiShui [2020] No. 32

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| <ul style="list-style-type: none">• IIT exemption designed to produce maximum 15% IIT rate for income of personnel with high-end and urgently-needed skills, working in Hainan FTP | <ul style="list-style-type: none">• Comprehensive income, operating income and Hainan government subsidies covered• Exemption obtained with IIT annual filing | <ul style="list-style-type: none">• Exemption does not cover investment or asset transfer income.• Exemption should cover income of partners in a fund, as operating income, though more clarity needed• Eligibility criteria will consider residence permit (hukou), social security contributions, and number of days spent in Hainan (possibly 183 day requirement)• Remains to be seen how non-resident individuals can access exemption (they are not required to perform the annual IIT filing) |
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VAT

To be clarified

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| <ul style="list-style-type: none">• Consolidate various turnover taxes (VAT, consumption tax, vehicle purchase tax, etc) into single 'sales tax', levied at 'retail stage' on goods/services | <ul style="list-style-type: none">• Detailed collection rules for 'sales tax'• Interaction with turnover tax regimes elsewhere in China | <ul style="list-style-type: none">• China plans to further 'simplify' its VAT rates structure so the same is expected for 'sales tax'• 'Retail stage' needs to be further defined |
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➤ Implement before 2035

To be clarified

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| <ul style="list-style-type: none">• 15% CIT rate scope expanded all Hainan FTP enterprises not in a 'negative list' sector• IIT levied at 3%, 10% and 15% rates for all individuals (not just special skills) in Hainan FTP for 183 days in year | <ul style="list-style-type: none">• Industries on the negative list need to be clarified• Day-count rule for 183 days• Requirements for social security contributions | <ul style="list-style-type: none">• CIT/IIT revenues to be shared by central and local governments• Revenues from 'sales tax' and other taxes deemed as local revenues |
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KPMG recommendations

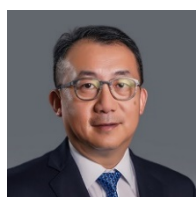


Many businesses are actively looking at establishing operations in Hainan FTP. The following should be considered:

- **Strategy and planning:** Some enterprises may look to leverage Hainan FTP's innovative new policies for a thorough restructuring or adjustment of their existing investment holding structure and operating model, including redeployment of human resources to Hainan and optimized financing arrangements.
- **Tax optimisation:** The tax cost savings from establishing operations in Hainan should be carefully evaluated against the tax position under China's standard tax rules, with the costs of managing economic substance requirements and revised TP arrangements taken into account.
- **Implementation:** Enterprises will need to assess any potential challenges arising in redeploying human and material resources, and set and oversee a step plan for any move to Hainan.

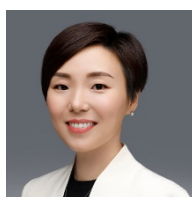
KPMG is closely monitoring the development of Hainan FTP. With its extensive experience, the firm can provide deep insights, advice and services in relation to industrial development planning, surveys on policy incentives, tax and customs optimisation, and assistance in accessing preferential regimes. See KPMG's tax alert on Hainan FTP from the customs angle [here](#).

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