



## First "zero-tariff" product list for Hainan Free Trade Port

### Summary:

- Chinese government authorities recently released the first “zero-tariff” product list for the Hainan Free Trade Port (“Hainan FTP”). This announces that, prior to the treatment of the entire Hainan island as a customs bonded area, raw and auxiliary materials imported by independent legal person enterprises registered in Hainan FTP can be exempted from import duty, import value-added tax (VAT) and consumption tax. This requires the imported materials to be used in the importers’ own manufacturing activities and processed for sale to overseas markets.

### Background



In June 2020, the Chinese central government released the Overall Construction Plan for Hainan FTP. Ultimately a zero-tariff rate will apply to a wide range of imports into Hainan island, which will be treated as a special customs bonded area. A simplified tax system (e.g. consolidation of various turnover taxes into a single ‘sales tax’) will also apply. Prior to this whole island regime coming into effect, certain categories of imports are entitled to import duty, import VAT and consumption tax exemptions. On 11 November 2020, the Ministry of Finance (MOF), the General Administration of Customs (GAC), and the State Administration of Taxation (STA) jointly released a Notice, in effect from 1 December 2020, to implement these exemptions.

### KPMG Observations



To some degree, the Notice breaks with the traditional customs supervision model using special customs supervision zones and bonded importation for the processing trade. The Notice clarifies that the zero-tariff treatment for raw and auxiliary materials will be subject to a catalogue system, and sets out a list of 169 items with their 8-digit HS Codes. This covers agricultural products (e.g. coconuts, barley, etc.), industrial raw materials (e.g. ores, coal, petroleum oil, liquified natural gas, wood, etc.), chemical raw materials (e.g. xylene, methanol, etc.), preformed bars for drawing optical fiber, base metal mountings, parts and components used for repair of aircraft and vessels (including repairs of relevant parts and components).

This Notice benefits agricultural processing, industrial manufacturing and energy enterprises by reducing their operational and capital costs. The "zero tariff" policy for parts and components used for repairing aircraft and vessels will also benefit the development of the aviation industry, aircraft repair industry, vessel repair industry, and the relevant processing and assembly industries.

In parallel, some compliance requirements are also set forth in the Notice. This requires that raw and auxiliary materials benefiting from zero tariff rates must only be used for production by the importer in Hainan FTP and be subject to customs supervision. They cannot be transferred within or outside the island. If transfer is required as a result of bankruptcy and other reasons, customs pre-approval needs to be obtained and taxes must be paid. If goods processed and manufactured with the zero-tariff raw and auxiliary materials are sold within the Hainan island or to mainland China, the import duty, import VAT and consumption tax shall be paid, and domestic VAT and consumption tax will also be applied. This, therefore, requires enterprises to plan ahead on the usage and flow of the materials ahead of importation. If the imported materials are for domestic sales, enterprises should declare to customs and pay the relevant duty/VAT.

In addition, enterprises can also apply with the customs authorities to voluntarily pay the relevant import VAT and consumption tax at the time of importing the listed raw and auxiliary materials. As such, businesses shall consider their business models and the overall tax burdens of the supply chain to judge the application of the preferential tax treatment.

The Notice emphasizes the utilization of information technology to supervise risks and illegal activities. It remains to be seen that whether the regulatory authorities would issue scrutiny rules for imported goods, businesses should pay close attention in this regard.

## KPMG Recommendations



The Notice is a substantial benefit for enterprises in Hainan FTP. Enterprises inside/outside Hainan FTP should pay attention to the following issues:

- Enterprises outside Hainan FTP should evaluate the feasibility of establishing a platform company/regional headquarters with functions such as import and export trading, investment and financing, logistics/supply chain management, so as to improve overall operations including investment, taxation, customs and trade;
- Enterprises inside Hainan FTP should assess the relevant preferential tax policies and regulatory requirements of the Hainan FTP, and take full advantage of the preferential policies for the imported goods on the basis of compliance;
- It should be noted that imported equipment and transportation means for own use are not included in the current "zero-tariff" product list. Separate lists to regulate imported production equipment for own use, imported transportation means for operation as well as the imported goods for consumption within the Hainan island are expected, businesses should keep close attention to these.
- The Notice indicates that the MOF and the relevant government bodies will adopt dynamic adjustment to the "zero tariff" product list, and therefore, businesses may voice concerns and make suggestions to the list.

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.

## Contact us:



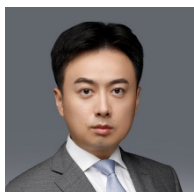
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