

China adopts the Hainan Free Trade Port Law

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In brief

On 10 June 2021, China's top legislature passed the Hainan Free Trade Port Law ("**FTP Law**"), which has taken effect immediately upon its issuance. The adoption of the FTP Law demonstrates a key move to convert the policies and incentives provided in the Hainan Master Plan (announced in June 2020) into effective and mandatory law. The enactment of the Hainan FTP Law is expected to serve as a pillar for transforming Hainan, a China southern tropical island, into a globally influential high-level free trade port.

In detail

The FTP Law stipulates a step-by-step approach in establishing a legal mechanism and governance to achieve facilities in free trade and investment, free cross-border capital flows, free and convenient transportation, and safe and orderly data flows.

Key provisions under the FTP Law are highlighted as follows:

1. Legislative and reform autonomy

The key significance of the FTP Law is to grant Hainan legislative and reform autonomy to reform its administrative, legislative and judicial mechanisms.

According to the FTP Law, Hainan is granted the authority to make and pass regulations on the FTP construction in light of Hainan's specific circumstances and actual needs as permitted by the legal framework. Hainan can even amend the current laws and regulations with justified reasons and proper filings with the State Council or National People's Congress Standing Committee, although special subject matters concerning China's sovereignty, functions of legislatures, administrative bodies or judicial institutions, criminal and civil legal regime, fundamental systems regarding tax, foreign trade, banking, finance, customs, etc., must be approved by the Standing Committee of the National People's Congress.

2. Facilitation of free trade and investment

The FTP Law lays down a fundamental legal framework to establish the free trade port in an orderly manner.

According to the FTP Law, Hainan will adopt various measures to facilitate free trade and investment, offer more comprehensive protection for intellectual property rights and promote fair competition.

The procedures for market entry, business presence establishment, exit from the market (e.g. dissolution and bankruptcy) and business operations will be further streamlined and more business friendly. The negative list for foreign investment in Hainan will be much shorter compared with the national negative list and the negative list adopted for free trade zones in China. Except for those sectors involving state security, social stability, ecological protection and significant public interest, the market in Hainan will be fully opened to international and domestic investors.

One of the most eye-catching highlights of the FTP Law is the market access commitment system. According to the FTP Law, the market entry will be based on the undertakings of business operators instead of government approvals. The supervision during the operation process will be emphasised. The administrative measures on market access commitment regime are to be formulated by the Hainan government and the state council.

A draft Administrative Measures on Market Access Commitment was issued by Hainan on May 24, 2021 for public consultation. According to the draft measures, the approvals and licences for industries other than state security, social stability, ecological protection and significant public interest will be repealed and replaced by proper undertakings and filings. The exact approvals and licences subject to market access commitment regime and list of filing authorities will be announced to the public. If the implementation of market access commitment regime requires amendments to the existing laws, the relevant legislation will be amended in advance. Once finalised and effective, such administrative measures will have significant impact on the investment in Hainan.

Turning to free trade, Hainan aims to realise trade facilitation by establishing free entry and exit, safe and convenient goods trade management system and optimised service trade system. The island-wide customs clearance regime will be adopted in Hainan, including customs clearance facilitation policies to simplify the flow of goods and procedures. The Customs authorities will adopt and apply facilitated and simplified Customs clearance procedures for efficient release of goods entering the Hainan FTP, except for those subject to mandatory inspection, quarantine or import/export licence.

3. Tax implication and risk management

The tax regime will be simplified in Hainan. Several types of taxes such as value-added tax, consumption tax, vehicle purchase tax, urban maintenance and construction tax, etc. will be consolidated, and the sales tax will be imposed on retail of goods and services. After the tax reform, Hainan will implement catalogue management on imported commodities, and commodities beyond the catalogue can be imported into Hainan without any customs duty. In addition, commodities imported into the other regions of mainland China via Hainan will be taxed in principle (except the commodities that can be exempted from customs duty according to relevant regulations).

According to the FTP Law, qualified companies incorporated in Hainan FTP should be entitled to the preferential CIT policy, and qualified individuals employed in Hainan FTP should be entitled to the preferential IIT policy.

From CIT perspective, substance requirement is the key. In the Notice jointly issued by the Hainan Provincial Tax Bureau, Hainan Provincial Department of Finance, Hainan Provincial Administration for Market Regulation, regarding the Issues in Substantive Operations of Enterprises Engaged within the Encouraged Industrial Category in Hainan Free Trade Port (the "Notice") in March 2021, substance operation is further categorised into 4 scenarios to explain the requirement, including: 1) Enterprises registered in FTP with no branch registered outside FTP; 2) Enterprises registered in FTP with branches registered outside FTP; 3) Enterprises registered outside FTP with branches registered in FTP; 4) Non-Tax Resident Enterprises set up Establishments or Places (E&Ps) in FTP. Comprehensive analysis will be performed by tax authority to determine the substance operation status of enterprises.

From IIT perspective, talents who enjoy the preferential IIT policy in Hainan FTP must meet the following basic requirements:

- Domestic talents: They must pay social insurance such as basic pension insurance in the Hainan FTP for more than six months in a single tax year (December of the current year included). They must be bound by job contracts or employment agreements (or other labour relationship supporting documents) for more than one year with enterprises or entities registered and substantially operating in the Hainan FTP.
- Overseas talents who are unable to pay social insurance: They must be bound by job contracts or employment agreements (or other labour relationship supporting documents) for more than one year with enterprises or entities registered and substantially operating in the Hainan FTP.

Generally, one of the current focuses of Hainan FTP is to attract talents, while the arrangement of the talents shall always be matched with the business and operation needs of the enterprise incorporated in Hainan.

4. Key industries

Hainan is set to build an open and ecological service industry system, laying emphasis on the key industries of tourism, modern service industries, high-tech industries, high-efficiency tropical agriculture. In particular, Hainan will foster new forms and models of tourism, promote the in-depth integration of tourism and culture, sports, health and care industry. As for the modern service

industry, the goal is to build an internationally competitive marine service system by building international shipping hub and improving marine service infrastructure.

Potential investors in the above industries may need to keep close watch on further rules and measures to be formulated by Hainan to promote the investment in the relevant industry.

5. Other measures to improve business environment

As a window of China's opening-up and a pioneer in improving business environment, Hainan is expected to serve as a pilot region to build it into a world-class investment destination, with the following auxiliary measures contemplated under the FTP Law:

- entire opening up of the telecom industry in Hainan phase by phase
- encouraging safe, orderly and convenient data flows, promoting digital economy and exploring the arrangements for regional cross-border data transfers
- adopting a veto system for environmental protection and life-cycle accountability for damages to ecological environment, to achieve Hainan's liveability and sustainability
- promoting highly liberalised, convenient and open transportation policy, adopting more open shipping system, and relaxing airspace control and route restrictions
- adopting an efficient and convenient immigration and entry/exit system, expanding the scope and term for visa-free entry, and optimising entry and exit inspection procedures
- Adopting better policies to attract local and expat talents

The takeaway

China has made considerable progress in creating a better business environment in Hainan, and Hainan has seen rapid development in terms of attracting investment and talents as well as a large number of newly established market entities in the past few years.

As the first free trade port in mainland China, Hainan has become a hot destination to attract investment from both international and Chinese companies. It is reported that in 2020, the total number of newly established enterprises in Hainan is 149,100 (including 148,095 domestic companies and 1,005 foreign invested companies), a year-on-year increase of 113.71%. The 1,005 newly established foreign-invested enterprises amount to a year-on-year increase of 197.3%. The first 4 months in 2021 has witnessed 611 new foreign-invested enterprises in Hainan, a year-on-year increase of 460.55%. A number of well-known foreign companies in various industries have settled in Hainan island.

There are remarks that Hainan demonstrates the highest level of openness in the world today. Compared with other free trade ports in the world, the pros of Hainan lie not only in being open to the world, but also in the support of the huge Chinese market. Hainan is expected to be more and more attractive to foreign investors after deeper reform and more opening-up policies are put in place.

It is reported that Hainan is speeding up the local legislation in key areas for further opening-up and fostering business climate. The next few years could be a crucial period for Hainan to exercise its autonomy in piloting new reforms and envisioning the world-class legal environment. The further relaxed market entry policy, the streamlined government procedures for market entry and exit, shortened negative list, the market access commitment regime as well as these encouraging tax support measures, will have far reaching economic implications and attract more investment in Hainan.

Let's talk

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