

CHINA RELEASES MASTER PLAN FOR HAINAN FREE TRADE PORT

A MAJOR STEP IN FURTHER OPENING THE CHINESE ECONOMY

China established its first free trade zone in Shanghai in 2013, a move designed to find new ways to bring in foreign investment. Since then, it has opened 17 more free trade zones around mainland China. But the newest free trade port to be established in Hainan Province, an island off the southern coast of China, appears to be the government's most ambitious plan to date. Under the *Master Plan for the Construction of the Hainan Free Trade Port* ("**Master Plan**"), released by the State Council on 1 June 2020, the entire Hainan Island will be developed into a "globally influential, high-level free trade port" and the most open area in mainland China covering around 33,900 square kilometres in southern China.

As a guiding document, the Master Plan only outlines the general principles, development guidelines, and goals for the construction of the Hainan free trade port. While the terms are broad, they may be useful for understanding the direction of future economic reforms. This newsletter highlights the key points of the Master Plan and its potential impact on foreign investment in China.

editorial

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HIGHLIGHTS

Under the Master Plan, the Hainan free trade port should be established by 2025 and completed by 2035, focusing on liberalising and facilitating trade and investment. The Master Plan mainly outlines the following measures to achieve such goal:

1. Free Flow of Trade

To facilitate the free flow of cross-border trade, the entire Hainan Island will be zoned as a special customs supervision area implementing a reformed trading regime. In principle, subject to the catalogue of dutiable goods to be published, zero-tariff policies will be introduced for the trade of goods. A new import and export management system will simplify the administrative formalities for the transfer of goods between Hainan and abroad, while strengthening the management of goods flowing between Hainan and mainland China. For trade in services, operations will be permitted within the port.

2. Free Flow of Investment

There will be fewer barriers to market entry for foreign investment in the Hainan free trade port. For example, foreign investment in certain restricted industries that are normally subject to approval or licence will only require filings, while more prohibited industries will open to foreign investors. Meanwhile, administrative procedures will be optimised or eliminated to support business operations in the free trade port. The Master Plan also calls for an open, transparent and predictable environment with strengthened protections for intellectual property rights and fairness in market competition.

3. Free Flow of Key Production Factors

The Master Plan aims to foster new competitive edges for the free trade port by promoting the development of certain industries, including the tourism, modern services, and high-tech industries. The following measures have been proposed to aid the flow of key production factors:

- **Cross-Border Funds**

Not only will more financial sectors be open to foreign investors in the free trade port, financing resources will also be expanded to stimulate capital flow. Capital market reforms will be comprehensive and unprecedented, including the establishment of a multifunction free trade account regime based on the existing domestic and foreign currency accounts in China, the implementation of a new regulatory regime for foreign debt, the expansion of permitted uses of capital funds by foreign-invested enterprises (“FIEs”), and support in setting up exchanges and clearing centres for financial products related to energy, shipping, property rights, and equities. Furthermore, local banks will be allowed to directly handle foreign exchange registration for enterprises in the Hainan free trade port to be listed abroad. However, the potential impact of offshore funds’ access to and use in the Chinese market shall be further assessed before detailed measures to be published and implemented by the authority.

- **Personnel**

Immigration policies will be formulated to attract foreign talent in investment, as well as facilitate academic exchanges and business activities in the Hainan free trade port. The current visa-free entry programme will be widened and the length of time visitors are permitted to stay without a visa will be extended to encourage foreign talent and qualified foreign individuals to stay, reside, or work in the free trade port.

- **Transportation**

The free trade port will offer more relaxed transportation regulations, such as fewer constraints in shipping, loosened airspace controls, and the right of navigation. The expansion of the freedoms of the air (in particular the fifth and seventh freedoms) in the free trade port may boost the development of the tourism industry in Hainan. Restrictions on offshore financing for ships and aircrafts will also be removed to encourage the development of the transportation industry.

- **Storage**

Given the vast area of the Hainan free trade port, it is feasible for cross-border commodities to be processed, dispatched, traded, transferred, or stored within the port for a relatively low cost. Moreover, there will be no limit on time goods may be stored there, providing further flexibility for cross-border trade.

- **Data**

The free trade port will promote the cultivation and development of the digital economy and innovations in data protection, while still emphasising data transfer security. The telecommunications sector, which is generally restricted or prohibited to

foreign investment in China (e.g. basic telecommunications and call centres), will be opened up to foreign operators in the free trade port.

4. Tax Regime

Under the Master Plan, the Hainan free trade port will implement a tax regime characterised by a zero-tariff principle, low tax rates, and simplified tax categories.

- Zero Tariffs

The zero-tariff policies for trade in goods will be introduced in two phases. Before the free trade port goes into effect, certain goods will be exempt from import tariffs, import value-added tax (“VAT”), and consumption tax. After the free trade port goes into full operation, all goods imported into Hainan will be exempt from import tariffs (excluding certain goods to be listed in a catalogue).

To encourage the development of the manufacturing industry in the free trade port, no import taxes will be levied on products manufactured by free trade port enterprises in encouraged industries if the products contain no imported materials, or if they do, the added value from processing the imported materials in the free trade port totals at least 30%.

- Low Tax Rates

The free trade port will offer preferential income tax rates for enterprises incorporated and de facto operating in Hainan, as well as qualified individuals working in the free trade port. The Master Plan has already reduced the corporate income tax rate for FIEs incorporated in Hainan to 15% as from 1 June 2020. All enterprises incorporated there will also be exempt from corporate income tax on income derived from direct investments made abroad before 2025 in the tourism, high-tech or service industries, a measure that officials hope will make Hainan the prime location from which Chinese investors invest overseas.

- Simplified Tax Categories

The tax regime in Hainan will be reformed to reduce the tax burden for enterprises in the free trade port. The Master Plan proposes to combine the current tax categories (including VAT, consumption tax, vehicle purchase tax, urban maintenance and construction tax, and education surtax) and replace them with sales tax for both goods and services.

COMMENTS

In recent years, China has launched various rounds of reforms to further open up its markets to foreign investment. A wide range of measures have been implemented, such as reducing or removing restrictions on foreign investment in certain industries and accelerating administrative and legislative reform to improve the investment environment. It is therefore a strategic move to build an internationally competitive free trade port in Hainan alongside the implementation of other measures.

The Master Plan indicates a comprehensive construction of a free trade port in Hainan. Subject to detailed regulations and policies based on the Master Plan, it may reshape the layout of foreign investment in China, or even in East Asia, particularly considering the beneficial tax regime designed to compete for foreign investment against other international free trade ports. The new port is also expected to expand access for foreign investors to certain restricted industries, which may be another major advantage of the free trade port compared to other regions in China.

However, follow-up laws and regulations, as well as local supporting policies, still need to be elaborated to realise the goals laid out in the Master Plan. Gide will closely follow developments. In the meantime, please feel free to contact us if you require more information or have any questions.

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