Approval for the 15% preferential Corporate Income Tax rate for Qianhai, Hengqin and Pingtan new areas

The MOF and SAT jointly released Circular 26 on 25 March 2014 which officially states the policy for qualified companies in three new areas – Hengqin New Area (“Zhuhai Hengqin”) 1, Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (“Shenzhen Qianhai”) 2 and Pingtan Comprehensive Experimental Zone (“Fujian Pingtan”) 3 – to enjoy a reduced Corporate Income Tax (CIT) rate of 15 percent. The publication of Circular 26 also finally clarifies the uncertainties surrounding the CIT incentive policy. This is a welcome development for companies contemplating investing and settling in Zhuhai Hengqin, Shenzhen Qianhai and Fujian Pingtan, as the CIT policy is the major attraction for these three new areas.

Policy overview

In principle, the State Council has agreed on the overall development plan for Zhuhai Hengqin, Shenzhen Qianhai and Fujian Pingtan in 2009, 2010 and 2011 respectively and proposed the CIT incentive policy. The Investment Industries Catalogue/Permitted Industries Catalogue for these three areas have also been introduced one after another whereas the specific policy pertaining to CIT was not finalised until the recent publication of Circular 26. The preferential policy that qualified companies in the three new areas are eligible to enjoy a reduced CIT rate of 15 percent is now officially stated in Circular 26.

According to Circular 26, the criteria for enjoying the 15 percent preferential CIT rate are set out below:

1) Applicable scope
- Companies established in the specific zone

2) Applicable criteria
- The companies’ main business falls within the ‘Preferential CIT Catalogue’ in the specific zone.
- Revenue derived from the main business accounts for more than 70 percent of the total revenue (which refers to the total revenue as specified in Article 6 of the CIT Law, including income of monetary and non-monetary forms received from various sources).

Regulations discussed in this issue:

- Notice on Issuing Rules for Implementing Interim Measures for the Administration of Cross-Border Renminbi Loans in Qianhai, Shen Ren Yin Fa [2013] No. 2, issued on 5 January 2013

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1 Zhuhai Hengqin refers to the area of Hengqin Island that is blueprinted in the Overall Development Plan for Hengqin New Area issued in a reply by the State Council in August 2009.
2 Shenzhen Qianhai refers to the area of Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (“Qianhai Cooperation Zone”) that is blueprinted in the Overall Development Plan for Qianhai Cooperation Zone issued in a reply by the State Council in August 2010.
3 Fujian Pingtan refers to the area of Pingtan Comprehensive Experimental Area that is blueprinted in the Overall Development Plan for Pingtan Comprehensive Experimental Area issued in a reply by the State Council in November 2011.
3. Effective period

- From 1 January 2014 to 31 December 2020

Key points

- The CIT preferential policy came into force in the first quarter of 2014 for a period of seven years.

- A company can enjoy both this CIT preferential policy and other CIT incentives concurrently, as well as opt for the most preferential CIT rate, e.g. a company established in the new areas and which is recognised as a key software company may be able to enjoy the most preferential CIT rate of 10 percent.

- If a company is eligible for 50 percent CIT reduction on a regular basis, CIT may be collected at half of the tax payable calculated at the statutory tax rate of 25 percent.

- Where tax authorities find it difficult to determine whether the company’s main business falls within the ‘Preferential CIT Catalogue’, they may ask the company to provide documentary proof issued by relevant competent administrative departments under provincial (including sub-provincial) governments or authorised competent administrative departments at the next lower level.

- The approved ‘Preferential CIT Catalogue’ of these three new areas has relatively narrower scope compared to the existing ‘Investment Industries Catalogue/Permitted Industries Catalogue’. The details are summarised below:

<table>
<thead>
<tr>
<th>Area</th>
<th>Shenzhen Qianhai</th>
<th>Zhuhai Hengqin</th>
<th>Fujian Pingtan</th>
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</thead>
<tbody>
<tr>
<td><strong>Overview</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>‘Preferential CIT Catalogue’</td>
<td>21 industry sectors under four categories</td>
<td>72 industry sectors under five categories</td>
<td>127 industry sectors under five categories</td>
</tr>
<tr>
<td>1. Modern logistics services (4)</td>
<td>1. New and high technology industry (37)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Information services (8)</td>
<td>2. Medicine and health (13)</td>
<td></td>
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</tr>
<tr>
<td>3. Technology services (4)</td>
<td>3. Science education/ research and development (R&amp;D) (10)</td>
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<tr>
<td>4. Cultural innovation (5)</td>
<td>4. Cultural innovation (5)</td>
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<td></td>
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<td></td>
<td>5. Commercial services (7)</td>
<td></td>
<td>5. Infrastructure management (16)</td>
</tr>
<tr>
<td>‘Investment Industries Catalogue/Permitted Industries Catalogue’</td>
<td></td>
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<tr>
<td>Overview</td>
<td>112 industry sectors under six categories</td>
<td>200 industry sectors under eight categories</td>
<td>350 industry sectors under five categories</td>
</tr>
<tr>
<td>1. Financial services (23)</td>
<td>1. Tourism and leisure (10)</td>
<td>1. High technology industry (105)</td>
<td></td>
</tr>
<tr>
<td>2. Modern logistics services (18)</td>
<td>2. Logistics/ commercial/ business services (36)</td>
<td>2. Consumer services (108)</td>
<td></td>
</tr>
<tr>
<td>3. Information services (16)</td>
<td>3. Financial services</td>
<td>3. Agricultural and marine industry (20)</td>
<td></td>
</tr>
</tbody>
</table>
KPMG’s observations

The issuance of Circular 26 further implements the preferential policy and is a welcome development for companies intending to settle in any of the three new areas. We have noticed that the ‘Preferential CIT Catalogue’ for Zhuhai Hengqin and Fujian Pingtan mainly focuses on industries such as new and high technology, medicine and health, ecological and environmental protection, etc. while Shenzhen Qianhai focuses on modern logistics, information and technology services, as well as cultural innovation. However, all of the ‘Preferential CIT Catalogues’ for the three areas have a narrower scope than expected. In particular, financial services, which ought to be the primary industrial sector for Shenzhen Qianhai and Zhuhai Hengqin, have not been included in the finalised ‘Preferential CIT Catalogues’. As a result, these three areas will likely be less attractive to investors in certain industries. Based on our understanding, Qianhai Administration Bureau is currently considering providing supportive policies in other forms to the financial companies settled in or that will settle in Shenzhen Qianhai.

While enjoying the preferential CIT treatment, some issues may still need to be further clarified or noted, including the following:

- The preferential policies in Circular 26 have merely provided general descriptions to the industrial sectors. The investors and administrative authorities may therefore have different interpretations of the contents in the policies, which could lead to difficulties in implementing preferential policies. As such, we have made enquiries to Qianhai Administration Bureau in this respect and understand that at this stage they are actively bringing together different departments to formulate detailed implementation rules. We expect that the introduction of such implementation rules will effectively solve this problem.

- Apart from the two criteria mentioned above, Circular 26 has not yet set out any other additional conditions for different industries, and tax planning opportunities may be available for certain companies. For example, companies engaged in the high technology industry but which fail to meet the requirements for new and high technology enterprises may consider establishing an entity in these three new areas.

- As one of the criteria above, and in accordance with the provision in the CIT Law, the total revenue should include the income derived from the sale of goods, provision of services, transfer of property, dividends/bonuses/other equity investment, interest, rental, royalties, donations and other sources. A company may need to pay particular attention to any significant amount of non-recurring income as it may result in the main business income accounting for less than 70 percent of the total revenue.

- Where a company in one of the three new areas is used as the platform for outbound investment, the question of whether the 15 percent preferential CIT rate will apply to the foreign-sourced income for the purpose of calculating foreign tax credit has not been clarified in Circular 26. Assuming the answer is ‘yes’, it is believed that such policy will attract qualified companies to set up entities in these new areas as their overseas investment platform.
• Policies relating to renminbi cross-border loans were released prior to the issuance of Circular 26. Apart from the tax incentives, companies established in Qianhai may also take advantage of cross-border loans to finance business development in Qianhai at a lower cost.

In summary, the promulgation of Circular 26 provides the fundamental policy for companies established in Shenzhen Qianhai, Zhuhai Hengqin and Fujian Pingtan to enjoy the preferential CIT rate of 15 percent. As one of the first professional services organisations to enter into a cooperation agreement with Qianhai Administration Bureau, KPMG is pleased to provide assistance to those companies intending to invest in these three new areas. We will continue to closely monitor the development of the related policies so that we can provide the latest information and share our observations and opinions.