

China Tax Alert

Issue 36, December 2016

GAC's New Legislative Efforts to Promote Innovation of Processing Trade

Regulations discussed in this issue:

- Announcement of the General Administration of Customs of China on Regulating the Importation of Expendable Materials (GAC Announcement [2016] No.67, hereinafter referred as "Announcement No.67"), issued on 24 November 2016 and effective from 1 January 2017
- Announcement of the General Administration of Customs of China on Regulating Contract Processing Occurring within the Special Customs Supervision Zones (GAC Announcement [2016] No.68, hereinafter referred as "Announcement No.68"), issued on and effective from 25 November 2016
- Announcement of the General Administration of Customs of China on Issues in Relation to Export Processing (GAC Announcement [2016] No.69, hereinafter referred as "Announcement No.69"), issued on 25 November 2016 and effective from 30 November 2016

Background

The General Administration of Customs of China (GAC) has recently released several announcements on the supervision of the processing industry in China so as to ensure that the industry develops in a sound way, and is regulated and uniformly managed by the GAC.

As one of the batch, *Announcement No.67* was released by the GAC on 24 November 2016. This announcement regulates the management of expendable materials. The issuance of the announcement puts an end to the situation in which unified supervision in this regard has been absent for years, with guidance for operations to all local Customs and relevant enterprises.

In the wake of *Announcement No.67*, *Announcement No.68* was released on 25 November 2016, which stipulates the supervision of contract processing occurring within the Special Customs Supervision Zones (SCSZ) that has been in practice since 2004, and which offers instructions to enterprises within the SCSZ who use excess capacity to undertake processing activities from enterprises outside the SCSZ. With successful implementation of the pilot programs, the GAC released *Announcement No.69* on 28 November 2016, which sets forth rules for issues in respect of export processing.

In order to improve trade facilitation, on 29 November 2016, the GAC released *Announcement No.70* and *No.72*, according to which "enterprises' account books shall be recorded once and for all", "warehouse stock shall be managed according to status". With the issuance of the duo, the GAC is attempting to extend such innovative measures carried out previously in the pilot ones to all SCSZs..

Main contents

Announcement No.67:

Regulations discussed in this issue:

- Announcement of the General Administration of Customs of China on the Issue of Enterprises within the Special Customs Supervision Zones Reporting Account Books Once and for All (GAC's Announcement [2016] No.70, hereinafter referred as "*Announcement No.70*"), issued on and effective from 29 November 2016
- Announcement of the General Administration of Customs of China on Managing Warehouse Stock within the Special Customs Supervision Zones According to the Status (GAC's Announcement [2016] No.72, hereinafter referred as "*Announcement No.72*"), issued on and effective from 29 November 2016

The announcement sets forth the definition of expendable materials and the scenarios that are out of the scope, and lists goods that cannot be declared and imported on a bonded basis under processing arrangement. It also makes clear issues relating to supervisory manners of expendable materials and clarifies a declaration system based on their items and their subsequent disposal.

Announcement No.68

The announcement sets forth the definition of contract processing occurring within the SCSZ and goods for such processing. It emphasizes that the materials and components used for such processing include non-bonded items from enterprises outside the SCSZ and bonded items from enterprises within the SCSZ. However, in the latter case, the processing enterprises must report to the Customs in advance, which will request an increase or decrease in accounting upon review.

It stipulates the rules for the operation and supervision of trade. Processing enterprises within the SCSZ must prepare an electronic account book for such contract processing, and separate the goods for such purpose from other bonded goods in both management and stock. Those enterprises must fill in an *import/export checklist* and those outside the SCSZ must fill in an *import/export declaration* for the importation and exportation of the materials, components, and finished products through the SCSZ.

According to the announcement, the processing fees and the finished products shall be declared by the category of the goods, and VAT (value-added tax) will only be imposed on the processing fees and not on the finished products.

Announcement No.69

The announcement sets forth the definition of export processing and its scope. Enterprises must meet certain requirements before they can operate in the trade.

It also stipulates supervision methods to goods for export processing. According to the announcement, enterprises assigning export processing shall establish a paper account book before a computer-networked system becomes available. The announcement also clarifies the timeline, procedures, stipulated period and approach for cancellation upon verification for an enterprise to establish account book.

In accordance with the announcement, the goods for export processing for the sake of their finished products being imported to China for sale shall be declared by items, no tax shall be charged for the importation of the original goods, and the dutiable value shall be determined based on the export processing fees, cost of materials and components used for such processing, expenses on transportation of import and insurance.

Announcement No.70

According to the announcement, through a computer-networked system, enterprises within the SCSZ shall report in an account book the information of the company and the import/export goods on a one-off

basis to the Customs in charge. Upon the review and approval of Customs, those information can be used repeatedly whenever such information is requested.

Announcement No.72

According to the announcement, through computer-based supervision of the warehouse stock, non-bonded goods are allowed to be stored in the bonded warehouse within the SCSZ, not by method of declaration, and to be consolidated, distributed and exported offshore or to any other place in China outside the SCSZ along with bonded goods.

KPMG observations

Announcement No.67:

For years, enterprises have had to import expendable materials on a bonded basis according to their enterprise nature. Such practice makes an inconsistent supervision in this regard by all the local Customs. As one of the key reforms carried out by the GAC, Announcement No.67 sets forth the definition, supervisory manners, and declaration in relation to expendable materials under processing arrangement. Enterprises need to pay attention to the aspects relevant to them.

[The scope of supervision on a bonded basis of expendable materials](#)

Announcement No.67 stipulates the scope of supervision on a bonded basis of expendable materials, and enterprises should pay considerable attention to such changes.

[The declaration system](#)

As the Customs in charge exercises supervision of expendable materials on a bonded basis, enterprises have to pay attention to the following when declaring imports:

- Account book management: enterprises shall incorporate information on expendable materials, import materials and components for the relevant processing, and the finished products to be exported in an integrated account book and file it to the Customs in charge in accordance with the requirements.
- Declaration: enterprises shall declare expendable materials and other bonded materials and components by items.

Announcement No.68 and No.69

With the domestic market increasingly thriving, great efforts have been made to seek new directions in developing the processing trade. In 2012, Hunchun Customs carried out pilot projects of export processing in which the enterprises involved foreign labor in undertaking the processing work and imported the finished products to China for sale. In 2014, a number of pilot programs of contract processing occurring within the SCSZ were implemented. The two batches of projects have opened a new chapter of processing trade and injected vigor and vitality to processing enterprises both within and outside the SCSZ. Announcement No.68 and No.69

officially issued by the GAC set forth the definitions, locations where the processing activities shall occur, business forms and supervisory manners in relation to contract processing occurring within the SCSZ and export processing trade.

[Processing enterprises within the SCSZ](#)

Contract processing occurring within the SCSZ enables the processing enterprises to undertake processing business from foreign companies as well as domestic ones. On one hand, such enterprises can reduce their production costs by taking advantage of excess capacity; on the other hand, as the dutiable value is determined based on the processing fees, the tax cost is also reduced for them, which helps increase their competitiveness. Confronted with a situation where foreign demands are continuously decreasing and processing trade plunging, enterprises within the SCSZ should seize the opportunity to realize the transformation and upgrading of their processing sector.

[Processing enterprises outside the SCSZ](#)

With export processing coming into practice, enterprises outside the SCSZ are able to integrate personnel resources both at home and abroad to relieve themselves from overwhelming orders and overloaded assembly lines. In the meantime, for the sake of export processing, a tax relief can be temporarily claimed under guarantees in the exportation of raw materials, and import duties and other linkage tax will only be imposed on the added value generated abroad in the importation of finished products. As a result, enterprises outside the SCSZ are greatly relieved from tax burdens. In addition, the prosperity of contract processing occurring within the SCSZ makes more choices available to them in their search for a cooperative partner, which helps reduce their reliance on import products, save production cost, shorten production cycle and improve productivity. Also, they are encouraged to increase their competitiveness and seize opportunities generated by their counterparts within the SCSZ that produce high quality processing work with high technical standards.

[Announcement No.70 and No.72](#)

The SCSZs of all sorts across China have put into practice these two sets of innovative measures modelled on Free Trade Zones (FTZ), as they are expected to fulfill their role in connecting foreign and domestic markets and promoting the integration of foreign and domestic trade. It can be anticipated that more of the pilot programs under implementation in the FTZ will be adopted throughout the country in the future.

[Announcement No.70](#)

According to the announcement, enterprises within the SCSZ can file their account book once and for all. Such a policy will not only help improve the efficiency of Customs review and approval and reduce the responding cost, but also promote the development of such innovative businesses as “bonded exhibition trade” and “bonded repair services”.

[Announcement No.72](#)

A computer-networked system enables Customs to exercise unified supervision of bonded and non-bonded stock without the need to separate them into two different warehouses, which not only leads to lower cost and greater competitiveness for enterprises, but also helps tighten Customs' supervision of non-bonded warehouse stock through information on the enterprises made available for them in the network.

In addition, as enterprises within the SCSZ are transforming into operation models oriented to both foreign and domestic markets, together with boosting domestic purchasing and demands, pilot programs for enterprises obtaining qualification as general VAT taxpayers have been carried out in comprehensive bonded areas of Chongqing and Jiangsu with the purpose of encouraging the enterprises within these areas to make use of benefits brought by the tax system reform. Under this circumstance, a country-based practice of warehouse stock management according to status sets a solid basis for the successful implementation of such pilot programs in all SCSZs across China, which will ultimately make the enterprises involved become more competitive.

It should be noted that enterprises need to pay attention to compliance matters in case of inspections conducted by Customs in charge when attempting to use these newly issued measures to their advantage.

Services that can be provided by KPMG

We would like to advise the relevant enterprises to update their knowledge with regard to the various reforms and innovative measures that have been taking place in processing trade on a timely basis, and KPMG will be pleased to assist you with the following:

- Conducting health checks over their export and import business including processing trade to identify and assess the potential risks, and streamline their internal control and risk prevention measures;
- Optimizing their supervision of processing trade procedures to better apply these newly issued measures by services in respect of the establishment, review and management of their account book for processing trade in every aspect;
- Solving difficult issues regarding disputes over unit consumption and negotiation of taxes to be charged for sales on domestic market under processing trade;
- Applying for new opportunities such as bonded repair services outside the SCSZ and qualification as general VAT taxpayers for enterprises within the SCSZ.

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