KPMG

China Tax Alert

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Significant reduction of Import Tariffs on Automotive Vehicles and Parts

Topic discussed in this issue:

- *Announcement on the Reduction of Import Tariffs on Automotive Vehicles and Parts* (Shui Wei Hui Announcement [2018] No.3) issued on 22 May 2018 and becomes effective on 1 July 2018

Background

On 22 May 2018, the Customs Tariff Commission of the State Council issued the *Announcement on the Reduction of Import Tariffs on Automotive Vehicles and Parts* (Shui Wei Hui Announcement [2018] No.3), which reduces vehicle tariff rate of 135 tariff codes (25%) and that of 4 tariff codes (20%) respectively to 15%; and reduces auto parts tariff rates of 8%, 10%, 15% and 20% respectively for a total of 79 tariff codes to 6%. Commodities and tax rates covered are summarized below:

Commodity category	Commodity details	8-digit tariff codes	Existing MFN rates	MFN rates after tariff reduction
Automotive vehicles	Item 87.04: trucks with a vehicle weight above 5 tons	4	20%	15%
	Item 87.02, 87.03: passenger buses and other passenger vehicles; Item 87.04: trucks with a vehicle weight below 5 tons and other trucks	135	25%	
Automotive parts	Item 87.06: chassis for vehicles designed for off-highway use	1	8%	6%
	Item 87.06: chassis for trucks and other vehicles; Item 87.07: bodies of vehicles; Item 87.08: parts and accessories of various vehicles	70	10%	
	Item 87.08: non-driving axles and parts for large buses and other parts and accessories for special vehicles	2	15%	

	Item 87.06: chassis for large buses and crane lorries	2	20%	
	Item 87.08: frames or other parts of large buses and light trucks	4	25%	
Total		218		

Following the reduction, the most-favored nation (MFN) rate for automotive vehicles averages 13.8% while that of the auto parts averages 6%. The reduction of import tariff will have a far-reaching effect on the automobile and related industries.

We understand that commodities of corresponding tariff codes which have been entitled to the MFN rates under various free trade agreements (FTA) China entered into with other countries and regions (especially those under China-Korea FTA, China-ASEAN FTAs) will also be entitled to the reduced tariffs in the short term. Considering the practical operation of customs reporting system, for confirming whether the certificate of origin still needs to be submitted, guidance of the Customs in charge shall be sought in time.

KPMG Observation

1 Direct impact on various automobile entities

Potential direct impact on entities engaging in importing and manufacturing vehicles and auto parts (for definitions of suppliers, distributors and after-sale service providers, please refer to the *Measures for the Administration of Automobile Sales* (Decree [2017] No. 1 of the Ministry of Commerce)) includes:

- Suppliers (importers of automotive vehicles):

Apart from the direct cut in the tariff costs brought by the reduction of import tariff, the consumption tax levied on goods imported will also be lowered, which will be a good news to vehicle importers. In addition, the contraction of the tax base will lead to a reduction of VAT at import, and thereby increasing the cash flow of vehicle importers. It is worth noting, however, that the reduction in import VAT as an input tax will slightly inflate the tax base for calculating the surcharges, and similar effect can also be observed on importers of auto parts and components.

- Suppliers (manufacturers of automotive vehicles):

For entities engaging in car manufacturing, there will be a drop in the manufacturing costs due to the lower tariff costs of production parts and CKD after the tariff reduction. It is likely that manufacturers will consider increasing the purchase of imported parts.

- Manufacturers of auto parts:

The reduction of import tariffs on auto parts may weaken the price competitiveness of domestic manufacturers of alternative parts and components, which may in turn affect the bargaining power of domestic manufacturers of auto parts and downstream manufacturers of vehicles.

- Vehicle distributors and after-sale service providers (4S shops):

As automobile retailers and repairs and maintenance (R&M) service providers that interact with consumers directly, they are under the mixed influence of cheaper imported automobiles and parts on one hand, but lower price of end products on the other.

- Vehicle parallel importers:

As a new business model, parallel import has been developing rapidly over recent years. The tariff reduction may have some impact on the competitiveness of parallel imported cars, but the positive side is cost of imported R&M parts and components will be decreased.

2 Indirect impact on the automobile industry

The reduction of import tariffs on vehicles and auto parts will also have a significant impact on the pricing and supply chain management of automobile entities besides direct impact on import costs:

- The decline of import costs will have a lingering impact on operating costs of entities as it makes its mark on automobile multinationals when they develop and adjust their transfer pricing (TP) policies. In recent years, China Customs has been increasingly focusing on the TP arrangement of multinationals. As import costs of imported vehicles and auto parts decline and profits rise, it is more than likely that the Customs will challenge the pricing in related party transactions of imported vehicles and parts.

- Multinationals also need to optimize their cross-border supply chain by making timely response and adjustments in parts and components procurement, functional and risk management of related entities, as well as product sales.

The significant changes in car costs and prices will inevitably have an impact on other sectors of the automobile industry. For example, auto finance companies may need to adjust their financing scale, financing costs and auto credit policies in due course; while EV enterprises need to evaluate the cost of spare parts purchase, and accelerate the transformation of R&D results, so as to compete and cooperate with their counterparts in traditional automobile industry.

KPMG Recommendations

In order to cope with the potential impact of the tariff reduction in a proactive way, automobile entities are recommended to conduct a comprehensive evaluation of the impact and opportunities brought by the Customs policy change through the following aspects, which include but are not limited to:

- Make timely and reasonable arrangement for import logistics to meet the time limit imposed by the Customs on import declaration and enjoy the reduced tariff starting on 1 July;

- Review the TP policy and its implementation, and conduct a rationality analysis of dutiable price of imported vehicles and auto parts from the perspective of customs valuation in advance;

- Summarize and review HS codes of imported goods, conduct a quantitative analysis of imported goods that may be affected, and assess the accuracy and consistency of HS codes to fully enjoy the reduced tariff;

- Re-examine the existing trade model and revise the planning accordingly. For example, manufacturers of vehicles and components engaging in processing trade need to analyze the pros and cons of the bond model in view of the relatively high cost of bonded goods management against the backdrop of a significant reduction in tariff rates;

- Re-evaluate the method and results in determining origins of vehicles and auto parts if rate of preferential origins is claimed, in order to ensure compliance in determining the country of origin;

- Automobile entities that have been or are subject to the Customs' queries and apportionment adjustment of customs valuation, R&M expenses, and non-trade remittance (including royalties) are recommended to reassess the impact of the tariff reduction on each category of queries and apportionment results, and communicate with the inspection, tax management, price and other departments of the Customs on a timely basis.

How KPMG's Trade & Customs Team can help:

KPMG's Trade & Customs Team includes a unique combination of policy, process and technology specialists. By tapping into our wide range of trade and customs knowledge and experience, as well as a global network, we can deliver a successful trade solution implementation to improve the efficiency velocity and costs of managing trade operations globally.

We are able to provide the following services in response to the tariff reduction:

- Assist in reviewing prices, HS codes, origins, etc. of imported commodities, and assessing and quantifying their customs and tax implications taking into account the individual case of each enterprise;

- Advice enterprises on the optimization of cross-border supply chain in consideration of preferential policies such as the tariff reduction and FTAs, and provide assistance in implementation;

- Assist enterprises in detecting potential tax risks, working with the Customs in its queries and audits, and communicating with the Customs effectively and efficiently;

- Assist enterprises in conducting customs price research, completing annual price filing, applying for import price adjustments, and analyzing the customs impact on year-end transfer pricing adjustments.

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