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CHINA TAX ALERT

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Harmonising China Free Trade Agreements with bonded zones

Regulation discussed in this issue:

- Announcement of the General Administration of Customs No. 36 [2013] on Conventional or Preferential Tariffs Applicable to Goods Sold Domestically in Special Customs Supervision Areas and Bonded Supervision Areas

The General Administration of Customs (GAC) issued Notice No. 36 [2013] on 8 July 2013 to clarify the requirements and procedures for granting preferential treatment to goods that are imported through special customs supervision areas and bonded supervision entities (collectively referred to as 'bonded zones'). This new regulation applies to products deemed to qualify for preferential tariffs, either under a free trade agreement (FTA) or in accordance with special preferential duty rates for least developed countries — as evidenced by a valid certificate of origin (COO) or origin declaration (OD) — which are first entered and stored in bonded zones.

Background

Prior to this regulation, there was a considerable amount of unease and uncertainty regarding the Customs treatment of FTA qualifying goods that were passed through bonded zones. If FTA qualifying products were directly imported under general trading arrangements without passing through bonded zones, the preferential tariff would be readily granted as long as everything was in order. However, if the goods first passed through a bonded zone, Customs would be hesitant to allow the preferential rate when the goods were subsequently cleared for domestic sales. This was partly due to the lack of clear guidelines on how Customs should monitor the condition of the goods stored in bonded zones (and their pertinent documents) to prevent any breaches of FTA rules.

Various FTAs have a common requirement for qualifying goods not to be altered or processed before they are formally imported at the destination country. Although qualifying goods in bonded zones are already physically in China, these are not deemed to have been imported into China until cleared by Customs for the domestic market. Until recently, however, China Customs did not have any published guidance on how to enforce this FTA requirement within bonded zones to ensure that the goods were not manipulated at the bonded zone prior to their domestic sale. In the absence of such guidance, Customs would often take a conservative position by denying the preferential duty rate for these goods, thereby negating the FTA benefit and resulting in additional costs for importers.

GAC Notice 36 has opened up a more definite opportunity for companies in China that sell on and/or purchase FTA qualifying products from bonded zones to utilise preferential duty rates and lock in Customs duty savings throughout their supply chain.

Procedures and requirements

Below is a brief description of the requirements and processes companies should fulfil to secure this benefit:

Entry of qualifying goods into bonded zones

- Upon arrival of the shipment at the bonded zone, the importer should fill out an import declaration form or an imported goods registration list.
- At the same time, it should submit an application for domestic sales that includes the following documents:
    - A completed application form for 'preferential duty rate for domestic sales of bonded goods from bonded zones'
    - An original copy of the FTA COO or OD
    - Relevant commercial and transportation documents (e.g., commercial invoice, bill of lading, and packing list)
    - Other documents as required by Customs, such as Certificates of Non-Manipulation (CNM) if the goods passed through an intermediate country.

  All pages of these documents will be stamped by Customs to confirm their validity.

- The goods should be imported 'in the same batch', which means being transported by the same vehicle to the same port of entry and belonging to the same consignee using the same bill of lading.

Domestic sale of qualifying goods from bonded zones

- When the goods are cleared for domestic sale, the importer should present all the signed and stamped documents mentioned above to Customs and complete its import declaration form.
- The COO or OD should still be valid (i.e., not expired) when the goods it covers are domestically sold.
- If Customs is satisfied with the documentation, and determines that the goods were not manipulated in contravention of the FTA rules of origin, it will apply the preferential rate on the goods when they are cleared for domestic sale.

Flexibility granted by Notice 36

An important feature of this new regulation is the flexibility it provides for importers that find themselves in any of the following situations:

- *The valid COO or OD cannot be submitted at the time of importation*

  Provided that this occurred for a valid reason (e.g., force majeure), a cash deposit can be paid to Customs first. When the COO or OD arrives, it can be presented to Customs for verification and, if everything is in order, the deposit will be returned or transferred to duty/VAT payment.

- *The goods must be sold domestically in multiple batches*

  In this case, the original COO or OD for the first batch will be collected first. Customs will then sign and stamp a copy of the COO and application form and return these to the importer. The importer will resubmit these stamped copies when applying for each following batch. The stamped application form is returned to the importer each time until all goods covered by the COO are sold. However, this facility for multiple batches is currently only available as a pilot program for the Customs Districts of Tianjin, Shanghai, Nanjing, Qingdao, Guangzhou, and Shenzhen. Additional guidance on its implementation in other Customs districts may be expected at a later date.

- *The goods of a single batch must be divided into multiple shipments prior to reaching the port of call (e.g., using smaller vessels to bring the goods up the Pearl River prior to customs formalities)*

  In such circumstances, the Notice provides that segregating the goods into multiple shipments will not prevent Customs from still recognising them as coming from the same batch.

For goods that are transferred from one bonded zone to another prior to their domestic sale, the Notice makes explicit mention that these will be addressed at a later date, which is a good indication that this practical option will be made available in the future.

KPMG's observations

Even though Notice 36 clarifies and provides flexibility for companies bringing FTA qualifying goods into bonded zones, implementation challenges may still be expected for a number of reasons, not least of which is the strict paper-based rules which govern the notice. Currently, a missing stamp on a single page may disqualify an entire batch, so companies' record-keeping policies need to be robust enough to systematically contain the paperwork required. Companies planning to gain these benefits are therefore recommended to work closely with Customs practitioners and advisors beforehand.

Nevertheless, on the whole this may be regarded as a positive development that makes FTAs accessible to an even larger number of Chinese businesses. A study conducted several years ago by the Asian Development Bank (ADB) identified administrative costs and a lack of internal awareness as among the biggest impediments preventing companies from seriously pursuing FTAs. Notice 36 appears to address these hindrances for Chinese importers since it strives for clearer procedures and documentary requirements. Thus, this may lead to greater interest in FTAs among companies in China.

From another perspective, the basic principle established by this new regulation may also boost China's attractiveness as a regional logistics hub. The fact that multinational companies keen on preserving FTA benefits in China are being encouraged to import and store FTA qualifying goods in Chinese bonded zones for domestic sale represents a good start. In the same vein, since many companies that are planning to set-up regional logistics hubs now consider FTA benefits to be one of the key drivers of their decisions on where to locate their distribution centres, it may not be long before China considers extending this principle to include transhipment/re-exports of FTA qualifying goods destined for other countries (under non-China FTAs). Interestingly, the rules stipulated by Notice 36 to oversee the condition of goods within a bonded zone in order to ensure no product alterations already bear similarities to those applied in logistics/transhipment hubs like Singapore, which issues non-manipulation certificates to preserve the FTA qualification of goods even if these are not destined for the Singapore market.

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CONTACTS

Khoonming Ho
Partner in Charge, Tax
China and Hong Kong SAR
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Beijing/Shenyang
David Ling
Partner in Charge, Tax
Northern China
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Qingdao
Vincent Pang
Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Shanghai/Nanjing
Lewis Lu
Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Hangzhou
Martin Ng
Tel. +86 (571) 2803 8081
martin.ng@kpmg.com

Chengdu
Anthony Chau
Tel. +86 (28) 8673 3916
anthony.chau@kpmg.com

Guangzhou
Lilly Li
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen
Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Shenzhen
Eileen Sun
Partner in Charge, Tax
Southern China
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong
Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern China
David Ling
Partner in Charge, Tax
Northern China
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Vaughn Barber
Tel. +86 (10) 8508 7071
vaughn.barber@kpmg.com

Roger Di
Tel. +86 (10) 8508 7512
roger.di@kpmg.com

John Gu
Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Kevin Lee
Tel. +86 (10) 8508 7536
kevin.lee@kpmg.com

Paul Ma
Tel. +86 (10) 8508 7076
paul.ma@kpmg.com

Vincent Pang
Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Michael Wong
Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Jessica Xie
Tel. +86 (10) 8508 7540
jessica.xie@kpmg.com

Irene Yan
Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Leonard Zhang
Tel. +86 (10) 8508 7511
leonard.zhang@kpmg.com

Tracy Zhang
Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Abe Zhao
Tel. +86 (10) 8508 7096
abe.zhao@kpmg.com

Catherine Zhao
Tel. +86 (10) 8508 7515
catherine.zhao@kpmg.com

Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

David Chamberlain
Tel. +86 (10) 8508 7056
david.chamberlain@kpmg.com

Tony Feng
Tel. +86 (10) 8508 7531
tony.feng@kpmg.com

Tiansheng Zhang
Tel. +86 (10) 8508 7526
tiansheng.zhang@kpmg.com

Central China
Lewis Lu
Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Anthony Chau
Tel. +86 (21) 2212 3206
+86 (28) 8673 3916
anthony.chau@kpmg.com

Cheng Chi
Tel. +86 (21) 2212 3433
cheng.chi@kpmg.com

Chris Ho
Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Lily Kang
Tel. +86 (21) 2212 3359
lily.kang@kpmg.com

Sunny Leung
Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Christopher Mak
Tel. +86 (21) 2212 3409
christopher.mak@kpmg.com

Martin Ng
Tel. +86 (21) 2212 2881
+86 (571) 2803 8081
martin.ng@kpmg.com

Yasuhiko Otani
Tel. +86 (21) 2212 3360
yasuhiko.otani@kpmg.com

John Wang
Tel. +86 (21) 2212 3438
john.wang@kpmg.com

Jennifer Weng
Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

Grace Xie
Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Bruce Xu
Tel. +86 (21) 2212 3396
bruce.xu@kpmg.com

Zichong Xu
Tel. +86 (21) 2212 3404
zichong.xu@kpmg.com

William Zhang
Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

Michelle Zhou
Tel. +86 (21) 2212 3458
michelle.b.zhou@kpmg.com

Cheng Dong
Tel. +86 (21) 2212 3410
cheng.dong@kpmg.com

David Huang
Tel. +86 (21) 2212 3605
david.huang@kpmg.com

Dylan Jeng
Tel. +86 (21) 2212 3080
dylan.jeng@kpmg.com

Ho Yin Leung
Tel. +86 (21) 2212 3358
hoyin.leung@kpmg.com

Henry Ngai
Tel. +86 (21) 2212 3411
henry.ngai@kpmg.com

Amy Rao
Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Southern China
Eileen Sun
Partner in Charge, Tax
Southern China
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Sam Fan
Tel. +86 (755) 2547 1071
sam.kh.fan@kpmg.com

Angie Ho
Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Jean Jin Li
Tel. +86 (755) 2547 1128
Tel. +86 (592) 2150 888
jean.j.li@kpmg.com

Jean Ngan Li
Tel. +86 (755) 2547 1198
jean.li@kpmg.com

Lilly Li
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Kelly Liao
Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Michelle Sun
Tel. +86 (20) 3813 8615
michelle.sun@kpmg.com

Bin Yang
Tel. +86 (20) 3813 8605
bin.yang@kpmg.com

Hong Kong
Ayesha M. Lau
Partner in Charge, Tax
Hong Kong SAR
Tel. +852 2826 7165
ayesha.lau@kpmg.com

Chris Abbiss
Tel. +852 2826 7226
chris.abbiss@kpmg.com

Darren Bowdern
Tel. +852 2826 7166
darren.bowdern@kpmg.com

Barbara Forrest
Tel. +852 2978 8941
barbara.forrest@kpmg.com

Daniel Hui
Tel. +852 2685 7815
daniel.hui@kpmg.com

Charles Kinsley
Tel. +852 2826 8070
charles.kinsley@kpmg.com

John Kondos
Tel. +852 2685 7457
john.kondos@kpmg.com

Alice Leung
Tel. +852 2143 8711
alice.leung@kpmg.com

Curtis Ng
Tel. +852 2143 8709
curtis.ng@kpmg.com

Kari Pahlman
Tel. +852 2143 8777
kari.pahlman@kpmg.com

John Timpany
Tel. +852 2143 8790
john.timpany@kpmg.com

Wade Wagatsuma
Tel. +852 2685 7806
wade.wagatsuma@kpmg.com

Lachlan Wolfers
Tel. +852 2685 7791
lachlan.wolfers@kpmg.com

Jennifer Wong
Tel. +852 2978 8288
jennifer.wong@kpmg.com

Christopher Xing
Tel. +852 2978 8965
christopher.xing@kpmg.com

Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Rebecca Chin
Tel. +852 2978 8987
rebecca.chin@kpmg.com

Kate Lai
Tel. +852 2978 8942
kate.lai@kpmg.com

Alex Lau
Tel. +852 2143 8597
alex.lau@kpmg.com

Benjamin Pong
Tel. +852 2143 8525
benjamin.pong@kpmg.com

kpmg.com/cn