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CHINA TAX ALERT

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Sino-Korea AEO Mutual Recognition Entered into Force

Regulations discussed in this issue:

- *Announcement on the Implementation of Sino-Korea Authorised Economic Operator Mutual Recognition,* Announcement [2014] No. 20 from the General Administration of Customs of the PRC, released on 7 March 2014

Chinese enterprises with an AA rating and which engage in trade with Korea will now be able to enjoy expanded and preferential customs clearance benefits with the implementation of the Mutual Recognition Arrangement (MRA) between the General Administration of Customs of the PRC (GAC) and the Korea Customs Service (KCS) for Classified Management of the Enterprises System of the PRC and Certified Enterprises in Foreign Trade of the Republic of Korea.

This development can help reduce customs processing times and simplify clearance procedures for qualified enterprises. Companies with a rating lower than AA will now have more reason to consider applying for an enterprise rating upgrade, especially if they are currently transacting with Korea-based businesses (or are planning to transact with them). Meanwhile, Class AA enterprises and enterprises which will apply for this rating will need to have health checks done in advance in order to deal with customs validation.

Policy overview

On the heels of a successful pilot programme carried out by the GAC and KCS in August 2013, this MRA signifies an official commitment between the two governments to definitively implement these trade facilitation measures from 1 April 2014. The GAC formally announced the commencement of this MRA with its issuance of Announcement [2014] No. 20, or *the Announcement on the Implementation of Sino-Korea Authorised Economic Operator (AEO) Mutual Recognition.*

The concept of AEO was introduced by the World Customs Organization (WCO) and aims to build a partnership between customs and business, as well as to secure and facilitate global trade. Under this programme, customs authorities recognise enterprises that hold themselves to the highest standards of compliance, credit ratings and security management, and can authorise them to use certain preferential conveniences in their customs clearance operations.

Responding proactively to the WCO's call, China Customs signed and implemented the WCO Framework of Standards to Secure and Facilitate Global Trade, studied and practiced the AEO system from 2005 to 2008, and issued *the Measures of the GAC of the PRC on Classified Management of Enterprises* (Decree of the GAC No. 170, hereinafter referred to as "*Measures on Classification*") and the relevant supporting provisions. This marked China Customs' adoption of the AEO system into its domestic legislation. The current *Measures on Classification* (Decree of the GAC No. 197) includes the AEO system's substantive requirements for compliance, trade security, partnership between customs and business, measures on trade facilitation, and validation procedures.

China Customs considers enterprises with an AA rating to already be at the AEO level. Enterprises that currently have an A rating and who are interested in gaining AEO status will have to apply to the customs inspectors and pass certain validation procedures to be recognised as Class AA enterprises. The validation will consist of a customs audit to be conducted either by customs or a certified professional firm (e.g. KPMG) that will assess the enterprise's levels of trading supervision, customs management and overall compliance by reviewing the company's internal controls, financial practices, compliance standards and trade security measures with certain standards. There are currently around 3,000 Class AA enterprises in China.

Key provisions

- **Mutually recognised areas**

China Customs accepts Excellent Enterprises in Trade Security certified by Korea Customs as AEOs in Korea, while Korea Customs accepts Class AA enterprises certified by China Customs as AEOs in China.

- **Preferential measures**

AEOs will receive customs clearance benefits from both countries including: lower inspection rates of imported goods, simplified document review of imported goods, prioritised clearance treatment of imported goods, a special customs liaison to coordinate and resolve clearance issues, and prioritised treatment for difficulties in extraordinary cases. At the same time, duplicated physical inspections of imported goods in both countries will be eliminated.

To ensure the smooth implementation of the MRA, the customs departments in China and Korea carried out a pilot programme on 10 August 2013. During this pilot program, the import clearance times of Chinese pilot enterprises was reduced to only 167 minutes, or a 67 percent decrease, which attests to the enhanced convenience and efficiency. In comparison, the average import time for non-Class AA enterprises is 355 minutes.

- **How to declare**

➢ Goods that are exported directly to Korea by China certified AEOs should be declared to Korea Customs as follows: they should communicate their certified AEO number (AEOCN + 10-digit enterprise registration number from China Customs) to the Korean importer, who will obtain an overseas business partner code (CN + six-digit enterprise name + four-digit code + one-digit verified code) corresponding to the certified AEO number from Korea Customs, and input the enterprise information. Upon declaration by the importer, Korea Customs will examine the declared enterprise information against the information previously provided by China Customs. If the information is consistent, preferential treatment on clearance will be applied automatically.

➢ Goods exported directly to China by Korea certified AEOs should be declared to Korea Customs as follows: the Chinese importer inputs the AEO number certified by Korea Customs in the 'remarks' section of the Declaration Form of Imported Goods. China Customs will confirm the code using enterprise information previously provided by Korea Customs. If the information is consistent, preferential clearance treatment will automatically be applied.

KPMG's observations

At present, China Customs has signed three international AEO MRAs with Singapore, Korea and Hong Kong. The two MRAs with Singapore and Korea have now been implemented, and preparations are underway to implement the Hong Kong MRA. In addition, AEO MRAs with the EU, the US and Taiwan are currently being negotiated. Once these AEOs are online, accredited companies will be entitled to facilitated clearance in more countries by way of AEO mutual recognition.

After being certified as Class AA, Chinese enterprises will have to maintain their high management standards in foreign trade to continue benefiting from preferential treatment. According to China Customs regulations, enterprises that are found to be violating customs rules or taking advantage of their benefits to commit smuggling activities will be downgraded. To supervise Class AA and Class A enterprises, the GAC requires that local customs departments perform post-entry audits on these enterprises within three years of being certified. Thus, relevant enterprises are advised to conduct health checks in advance and develop a scientific system to manage and reduce risk.

KPMG services

If companies need support with this newly implemented AEO programme, KPMG can help them:

- Improve their levels of customs compliance, internal controls and supply chain management including internal procedures for critical customs operations such as clearance processes, duty payments, equipment management, foreign exchange, etc.
- Apply for Category AA status, including preparing and submitting documents, and communicating with relevant officers
- Conduct pre-emptive customs audits, as newly accredited Class AA companies would most likely face these within three years of being certified.

Should you have any questions, please contact the KPMG Customs team.

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