

# CHINA TAX ALERT

ISSUE 20 | July 2014

## China Customs Simplifies Approval Formalities for Processing Trade and Shifts Focus to Actual Supervision

### Regulations discussed in this issue:

- GAC Order No. 219, *Measures of the Customs of the People's Republic of China on the Supervision of Processing Trade Goods*
- GAC Announcement 2014 No. 21, *Announcement on Issues concerning the Implementation of GAC Order 219*
- GAC Order No. 218, *Decision of the General Administration of Customs on Amending Certain Regulations*
- GAC Order No. 216, *Decision of the General Administration of Customs on Abolishing Certain Regulations*

### Background

China's imports and exports benefit significantly from processing trade operations, but the administrative requirements for successfully operating a processing trade enterprise have been commonly perceived to be tedious and time consuming. For this reason, many industries have long been expecting Customs to introduce policies that will simplify the current approval procedures in order to improve efficiency. This is now becoming a reality. Recently, the General Administration of Customs (GAC) made some amendments to the processing trade regulations. These amendments simplify and standardise daily operational procedures with regard to matters such as handbook set up and verification, bonded goods outsourcing and factory transfers. At the same time, they also strengthen Customs' role in the actual supervision of relevant declaration data and the management of bonded goods. It is important, therefore, for processing trade companies to review the impact of the new regulations on their daily customs operations. Moreover, they should strive to enhance their trade compliance and internal control management capacity accordingly.

### What are the New Regulations?

Recently, GAC published the following new regulations for the processing trade:

- GAC Order No. 219, *Measures of the Customs of the People's Republic of China on the Supervision of Processing Trade Goods*
- GAC Announcement 2014 No. 21, *Announcement on Issues concerning the Implementation of GAC Order 219*
- GAC Order No. 218, *Decision of the General Administration of Customs on Amending Certain Regulations*, including amendments to the following processing trade regulations
  - ✓ *Administrative Measures of the Customs of the People's Republic of China on Administration of Bonded Groups Engaged in Import Processing,*
  - ✓ *Measures of the Customs of the People's Republic of China on Administration of Processing Trade Involving Multiple Locations,*
  - ✓ *Measures of the Customs of the People's Republic of China on Administration of Processing Trade Scrap, Residual Material, Defective Goods, By-Products and Bonded Goods Affected in a*

Disaster, and

✓ *Measures of the Customs of the People's Republic of China on Administration of Processing Trade Unit Consumption.*

- GAC Order No. 216, *Decision of the General Administration of Customs on Abolishing Certain Regulations, including 'Administrative Measures of PRC Customs on Factory Transfer of Bonded Goods Between Customs Districts'.*

In the updated regulations, it may be noted that the GAC retains basic processing trade principles, such as the requirement for accurate declarations in setting up Customs handbooks, handbook verification based on actual information, accurate declarations of unit consumption and the separate management of bonded and non-bonded goods. However, notable differences can be observed, such as:

New Regulations	Previous Regulations
<p><b>1. Simplified approval formalities for processing trade</b></p> <p>Bonded goods outsourcing, factory transfer, residual material carry-over, and other administrative approvals pertinent to handbook approval will be replaced by handbook set-up, bonded goods outsourcing filing, factory transfer declaration, residual material carry-over declaration and other verifications.</p>	<p>A business enterprise shall complete the formalities for set up, cancellation and verification of the processing trade goods manual with the Customs in charge at the location of the processing enterprise.</p> <p>Business enterprises that have received approval from the relevant department can carry out factory transfer and outsourced processing business.</p>
<p><b>2. The approval procedure for "giving up" bonded goods has been cancelled, while that of destroying bonded goods under customs supervision remains in place.</b></p>	<p>Residual material, leftover material, defective goods and affected bonded goods that cannot be used or returned can be cancelled after verification by local customs, who will carefully review the application to "give up" goods submitted by the business enterprise</p>
<p><b>3. Management requirements regarding factory transfer will be strengthened</b></p> <p>In addition to the originally disallowed factory transfer circumstances, a new provision stipulates that if the company does not receive or deliver goods in accordance with procedures required by customs, it will not be allowed to apply for factory transfer.</p> <p>Since GAC implemented a factory transfer management system nationwide in 2013, companies are required to declare their factory transfer application forms, goods delivery and receipt information to Customs within the prescribed time limit. If the company does not follow the rules, it may be disqualified from applying for factory transfer, at least temporarily.</p>	<p>Under any of the following circumstances, a processing trade enterprise shall not complete deep processing carry-over formalities:</p> <p>(1) the processing trade enterprise failed to comply with Customs regulatory requirements and has been ordered by Customs to correct its mistakes within a stipulated period, which has not yet expired;</p> <p>(2) the processing trade enterprise failed to submit its handbooks for verification within the stipulated period; or</p> <p>(3) the processing trade enterprise is under investigation by Customs for alleged smuggling and the case is pending.</p>
<p><b>4. Supervisory procedures for bonded goods outsourcing have been eased</b></p> <p>Bonded goods outsourcing registrations should be filed with Customs within three working days</p>	<p>Subject to approval by Customs, business enterprises may conduct outsourced processing operations.</p> <p>Under any of the following circumstances, the business enterprise applying to conduct outsourced</p>

<p>after the commencement of outsourcing.</p> <p>Companies will no longer have to pay a deposit unless they outsource an entire manufacturing process for their goods.</p> <p>The amendment supersedes the previous regulation and is intended to allow domestic companies, and even individuals without customs registration, to legally act as contracted processors in the outsourcing of more labour-intensive operations that require less sophisticated manufacturing equipment.</p>	<p>processing operations shall provide a security deposit of an amount equivalent to the tax amount payable or a bank letter of guarantee for outsourced processing goods to Customs:</p> <p>(1) The outsourced processing activities span different Customs regions;</p> <p>(2) The entire workflow is outsourced;</p> <p>(3) The goods are not shipped back to China and are exported directly upon outsourced processing; or</p> <p>(4) The goods under the application for outsourced processing are not embroiled in a lawsuit, but the business enterprise or the contracting enterprise is alleged of smuggling or violating the regulations, and is subject to case filing and investigation by Customs, or is under criminal investigation and the case has not been concluded.</p>
<p><b>5. The supervisory requirements for the interchange of bonded and/or non-bonded materials have been further standardised.</b></p> <p><b>Restrictions that limit material interchange to situations in which it is “urgently required to process export goods orders” has been removed</b></p>	<p>Upon Customs approval, business enterprises that are urgently required to process export goods orders may swap between bonded materials, or between bonded materials and non-bonded materials, provided that the swapped materials belong to the same enterprise, and the swapping shall comply with the principles of same product type, same specifications, same quantity and non-profit.</p>
<p><b>6. Letters of guarantee issued by non-bank financial institutions as a legal means of collateral in the procedure of handbook setting and bonded goods outsourcing is allowed</b></p>	<p>Only letters of guarantee issued by banks or deposits are allowed</p>
<p><b>7. The direct export of bonded raw materials imported via Customs handbook for after-sales service is allowed</b></p>	<p>Where there is a need to return imported materials to the original supplier due to quality defects or variance in specifications and model number against the specifications and model number in the contract, or if there is a need to export unprocessed bonded materials due to after-sales services for exports under processing trade, the business enterprise may complete Customs declaration formalities directly with Customs.</p> <p>Bonded imported materials that have undergone processing shall not be exchanged.</p>
<p><b>8. Processing trade companies are</b></p>	<p>Processing trade companies should</p>

<b>exempted from submitting annual reports of operating activities</b>	submit annual reports of operating activities to Customs according to the corresponding regulations.
--	--

#### **Areas to be further clarified:**

- In the past, GAC has put forward many different kinds of management models for the processing trade, such as the online supervision model, the special industry model (for airplane and ship manufacturers), and the special customs supervision zone model. The newly amended *Measures on Supervision of Processing Trade Goods* introduces a classified supervision mechanism for the processing trade. How the new mechanism will work in conjunction with the existing models is still unclear, although companies with a high customs rating (A or AA), as well as high-tech and high value-added industries, are likely to be granted more convenient management models. Even so, all companies are encouraged to strengthen their levels of trade compliance and enhance internal controls, so as to better adapt to more sophisticated and direct supervision by customs.
- In the new regulations, customs reiterates that bonded goods and non-bonded goods should be stored and recorded separately. If it is impossible to separate the goods, Customs will check the company's internal information management system to make sure that the company manages those goods separately. In practice, it is not yet clearly and uniformly stated how customs will examine companies in different industries or with different MRP/ERP systems. However, it is clear that companies which cannot physically separate their bonded and non-bonded goods should perform a detailed study on how to utilise customs management software in order to virtually separate bonded and non-bonded goods/raw materials. Otherwise, they will face significant customs risks.
- The recent regulations do not contain many updates regarding unit consumption management. However, as unit consumption management is the core of processing trade management, we foresee that China customs will continue to improve its unit consumption management by striking a balance between simplifying declaration procedures and intensifying its post-declaration supervision of actual unit consumption. We have observed that many processing trade companies adopt a less refined or rough management style in their unit consumption. However, in the future, they will have to come up with a proposal for their unit consumption declaration based on actual data derived from their production technical process or business operation, so as to remain compliant with the customs requirement to make accurate and timely declarations of per unit consumption.



## 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

## Chengdu Anthony Chau

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

## Hangzhou John Wang

Tel. +86 (571) 2803 8088  
john.wang@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

### Tracy Zhang

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

### Abe Zhao

Tel. +86 (10) 8508 7096  
abe.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

### Li Li

Tel. +86 (10) 8508 7537  
li.li@kpmg.com

### Alan O'Connor

Tel. +86 (10) 8508 7521  
alan.oconnor@kpmg.com

## Joseph Tam

Tel. +86 (10) 8508 7605  
laiyu.tam@kpmg.com

## Anni Wang

Tel. +86 (10) 8508 7518  
anni.wang@kpmg.com

## Sheila Zhang

Tel. +86 (10) 8508 7507  
sheila.zhang@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

## Ho Yin Leung

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

## Sunny Leung

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

## Christopher Mak

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

## Henry Ngai

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

## Brett Norwood

Tel. +86 (21) 2212 3505  
brett.norwood@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

## 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

## Amy Rao

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

## Henry Wong

Tel. +86 (21) 2212 3380  
henry.wong@kpmg.com

## Southern China Eileen Sun

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

## Vivian Chen

Tel. +86 (755) 2547 1198  
vivian.w.chen@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

## Lilly Li

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

## Kelly Liao

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

## Bin Yang

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

## Penny Chen

Tel. +86 (755) 2547 1072  
penny.chen@kpmg.com

## Grace Luo

Tel. +86 (20) 3813 8609  
grace.luo@kpmg.com

## Maria Mei

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

## Michelle Sun

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

## Lixin Zeng

Tel. +86 (20) 3813 8812  
lixin.zeng@kpmg.com

## Hong Kong

### Ayesha M. Lau

Partner in Charge, Tax  
Hong Kong SAR  
Tel. +852 2826 7165  
ayasha.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

### 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

## Adam Zhong

Tel. +852 2685 7559  
adam.zhong@kpmg.com