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CHINA TAX ALERT

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China to update customs audit regulations

Regulations discussed in this issue:

- The Legislative Affairs Office of the State Council of the PRC is holding public consultations on the *Customs Audit Regulations of the People's Republic of China (Revision Draft)* prepared by the General Administration of Customs of the PRC (hereinafter referred to as the 'Revision Draft'). The new *Customs Audit Regulations* is expected to be released this year.

Background

More than two decades after the first *Customs Audit Regulations of the People's Republic of China* (State Council Order No. 209) were released, the same regulations are now up for revisions within the year to meet the demands of a changing commercial and enforcement environment. In order to respond to the specific concerns of businesses and the general public, the Legislative Affairs Office of the State Council of the PRC has released a draft of the new regulations ("the Revision Draft") for comments.

For the benefit of companies interested to know more about the possible changes to the regulations, we have prepared in this Alert a summary of the key revisions and how this may have an overall impact in the way Customs and businesses interact.

Key points

To align the current audit rules with the trade facilitation objectives of the China Customs Law, international rules, and the globally accepted best practices, the Revision Draft pushes the customs compliance function further up to the level of higher management, requiring them to adopt higher standards for risk management, credit management and overall enterprise self-discipline. To reduce bureaucratic barriers, Customs role would be limited to ensuring that these standards are adhered to.

Some notable features of the Revision Draft are as follows:

1. Shifting the primary focus of customs audits

The Revision Draft gradually shifts the focus of customs audits from 'examination' to 'management.' Instead of making detailed examinations of company accounts, documents and goods, Customs will make an overall assessment of the company itself and its risk management capability. Customs will no longer rely exclusively on follow up supervision but will take careful note of the company's capacity to pre-assess its imports/exports, credit status and risk status; and conduct post-import/export reviews to verify the accuracy and propriety of its import and export activities.

The following two aspects of the new customs audit guidelines are particularly relevant to enterprises:

- *Establishing an enterprise self-discipline system* - Article 11 of the Revision Draft provides that: 'A company under audit that is able to carry-out self-compliance management on their operations may report any instances of non-compliance to Customs and take prompt corrective action. In such cases, administrative penalties will be reduced or may be waived particularly for minor torts that are quickly corrected and do not result in any damages.'

- *Establishing an internal control system according to customs requirements* - Article 9 provides that: 'The companies being audited should establish an import/export internal control system according to customs requirements and accept customs supervision and inspection.'

2. Protection of the legitimate rights and interests of auditees

The Revision Draft protects the legitimate rights and interests of companies being audited by standardising the notification and review procedures. Article 21 provides that: 'Customs should inform the auditees of the facts obtained through a customs audit before reaching an audit conclusion; companies who have factual objections should express their opinion to Customs within seven days from the date that the information is issued to them.' This provision protects the companies' right to know the legal basis for any administrative enforcement, as well their right to reply and prepare a defense. Furthermore, Article 22 provides that: 'Customs should review any facts that are questioned by the companies being audited and any reasonable explanation raised by the auditees should be accepted by Customs.'

3. Transforming Customs functions and improving management efficiency

- The "Revision Draft" introduces a legal provision allowing third party intermediaries to conduct customs audits.

  The notion of enlisting third party intermediaries to assist in Customs enforcement is not new. Third parties were already allowed when the *Measures of the Customs of the People's Republic of China on Inspection of Bonded Zone Operations* were issued by the General Administration of Customs (GAC) and took effect 1 June 2008. Since third party intermediaries have a wealth of both domestic and international experience, local Customs authorities are seen to benefit from the former's involvement.

  We understand that Customs will publish the qualifications and management regulations regarding the third party intermediaries at a later date.

- Customs will rely on risk management and credit management in conducting its audits.

  As a member of the World Customs Organisation (WCO), China Customs has also established an enterprise classification management system that follows principles similar to the Authorised Economic Operatory (AEO) system whereby Customs identifies and grants cargo clearance benefits to enterprises with exceptional track records in compliance, credit, and cargo security. China Customs has been continually improving its enterprise credit and risk management systems and the Revision Draft aims to strengthen this further.

  Article 4 of the Revision Draft provides that customs audits should be conducted more along the lines of enterprise credit management and import/export risk management. Instead of a one-size fits all approach, Customs will decide on the key audit areas based on the import/export credit status and risk status of the auditees, thereby improving the efficiency and effectiveness of the Customs audit. Upon conclusion of the audit, Article 17 provides that Customs would have the right to adjust the company's enterprise credit records according to results and findings.

KPMG's observations

The overall intention of the Revision Draft is positive and represents a win-win situation for both enterprises and Customs. Looking ahead, enterprises should pay close attention to the following points:

- The upcoming *Customs Audit Regulations* will introduce an enterprise self-disclosure system, for the first time. Under the current system, Customs is not obliged to grant lenient treatment in any circumstances, which imposes a high-level compliance dilemma on the part of the enterprises. However, the enterprise self-disclosure system in the Revision Draft is rather vague since it does not offer specific solutions for different self-disclosure problems and does not define the conditions in which an enterprise would be precluded from leniency. These anticipated lack of detail in the upcoming *Customs Audit Regulations* may cause confusion and inconsistent standards being applied in different circumstances. Enterprises would therefore still have to be cautions when making self-disclosures.

  Some local Customs authorities have already carried out enterprise self-discipline practices. For example, Tianjin Customs has already introduced self-checking and self-reporting of royalties. Furthermore, after GAC issued the *Notice of the General Administration of Customs on Carrying Out the Enterprise Self-discipline Management Pilot and Research Work* (GAC Auditing Division [2014] No.111), it began to organise self-discipline pilot programmes in ten local Customs authorities, including Beijing, Tianjin, Qingdao and Shenzhen. Currently, the pilot self-compliance program is being conducted in 10 customs districts but we expect similar pilot programmes to soon be carried out all over the country Thus, we would encourage enterprises to make early preparations.

- Since the upcoming *Customs Audit Regulations* would requires a higher standard of internal customs management, enterprises would be advised to likewise enhance their internal management systems so as to meet these higher standa*rds.*

KPMG services

To help enterprises prepare themselves for these imminent changes and developments the Customs audit regime, KPMG extend its support in the following areas:

- Assisting enterprises strengthen customs compliance and internal control management, including clearance processes, duty payments, equipment management, foreign exchange, etc.

- Assisting enterprises apply for AA(AEO) rating and credit rating upgrades, including the preparation/submission of documents, and communication with relevant officers.

- Helping enterprises prepare for customs audits and to issue professional assessment reports related to their import/export business.

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