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CHINA TAX ALERT

ISSUE 26 | September 2014

Importation of steel materials can no longer enjoy bonded treatment under processing trade from 1 January 2015

Regulations discussed in this issue

- The Notice on Revoking the Bonded Treatment for Steel Materials Imported under Processing Trade, *Cai Guan Shui [2014] No. 37, issued on 2 July 2014*
- The Supplementary Notice on Revoking the Bonded Treatment for Steel Materials Imported under Processing Trade, *Cai Guan Shui [2014] No. 54, issued on 28 August 2014*

Background

On 2 July 2014, the Ministry of Finance (MOF), General Administration of Customs (GAC) and State Administration of Taxation (SAT) jointly issued '*the Notice on Revoking the Bonded Treatment for Steel Materials Imported under Processing Trade*' (Cai Guan Shui [2014] No. 37, hereafter referred to as 'the Notice'). The Notice stipulated that steel materials under 78 tariff codes would no longer enjoy bonded treatment. The steel materials specified in the Notice include hot-rolled plate, cold-rolled plate, riffled steel, steel rod and wire, shaped steel, iron and steel wire, electrical steel and other steel products, all of which can be produced domestically with a quality that should be able to fulfil the demand of downstream processing enterprises. Upon implementation of the Notice, Customs duty and import taxes will be imposed on the aforesaid steel materials that were previously imported under processing trade.

The Notice was to be effective 31 July 2014; however, on 28 August 2014, MOF, GAC and SAT jointly issued 'the *Supplementary Notice on Revoking the Bonded Treatment for Steel Materials Imported under Processing Trade*' (Cai Guan Shui [2014] No. 54, 'the Supplementary Notice'), which prescribed that, based on approval from the State Council, the transitional period for the revoke of bonded treatment for the steel materials under the 78 tariff codes, would be extended until 1 January 2015.

Outlines of the Regulations

1. Bonded treatment for steel materials under the 78 tariff codes that are currently imported under processing trade will be revoked, and the Customs duty and import-related taxes will be imposed effective 1 January 2015.

   The major feature of the processing trade regime is to grant preferential bonded treatment to the importation of raw materials, provided that they are used for production and assembly of finished products for export. If the raw materials imported under the processing trade regime, or the finished products manufactured using the raw materials, are diverted for domestic sales, China Customs will collect the corresponding customs duty and import-related taxes. By engaging in processing trade, enterprises can improve their cash usage efficiency, reduce interest expenses, and more importantly, reduce their production costs and increase their products' competitiveness.

The revoking of the bonded treatment for steel materials will adversely impact the competitiveness of the imported steel materials. Imported steel materials will no longer enjoy the bonded treatment and the simplified import procedure applicable under the processing trade regime. As a result, domestically produced steel materials will become more competitive and bring fair competition between steel materials imported and produced domestically.

2 If a buy-sell contract for steel materials is signed before 31 December 2014, and the steel materials are physically imported before 30 June 2015, the steel materials can still enjoy the bonded treatment as long as the contract is still valid.

To continue enjoying the bonded treatment after 1 January 2015, the following two conditions must be met: 1) the contract was signed before 31 December 2014; 2) the steel materials are physically imported before 30 June 2015.

If the contract is signed after 1 January 2015, or the contract is signed before 31 December 2014 but the importation is performed after 30 June 2015, the bonded policy cannot be applied and the enterprise needs to pay customs duty and import-related taxes.

3 The cancellation of the bonded policy as stated in the Notices is applicable to enterprises established in the customs special supervision areas, which include free trade zones, export processing zones, bonded logistics parks, bonded ports, integrated bonded zones, and cross-border industrial zones as well as the China (Shanghai) Pilot Free Trade Zone.

However, as a temporary policy,enterprises engaged in processing trade but established in relevant areas before 31 July 2014 will be unaffected by the revoking of bonded policy, and will not need to pay customs duty and import-related taxes when importing steel material products. Such enterprises will be able to continue to enjoy bonded treatment.

KPMG Observations

The bonded treatment has been revoked in accordance with Circular Guo Fa [2013] No. 41 (i.e. Guidance on Resolving the Serious Excessive Production Capacity), published by the State Council. The circular stated that "a fair tax policy should be implemented by revoking the bonded treatment of steel products that are imported under processing trade regime."

Imported steel materials are covered by approximately 200 tariff codes; however, only 78 tariff codes have been specified in the Notice and the Supplementary Notice. We foresee that the MOF, GAC and SAT will further issue regulations on the revoke of bonded treatment for the steel materials that are covered by other tariff codes. Hence, we recommend that enterprises importing steel materials under the processing trade regime consider the potential impacts that the changes could bring to their operations and develop a plan to mitigate the effects even if the steel materials they currently import are not within the 78 tariff codes. We recommend that those enterprises importing steel materials within the 78 tariff codes arrange an importation batch before 31 Dec 2014 to reduce unnecessary losses.

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