General Office of the State Council issued *Plan on Speeding up the Integration and Optimisation of Areas under Special Customs Supervision*

Regulations discussed in this issue:

- *Notice on Distributing the Plan on Speeding up the Integration and Optimisation of Areas under Special Customs Supervision*, Guo Banfa [2015] No.66, issued on 28 August 2015

Background

Since the establishment of the first bonded zones in 1990, many areas under special customs supervision with different positioning and different functions have emerged in China. Economic development needs led to the creation of these areas; and they in turn have contributed to the economic growth. Over the past 25 years, China's economy, as well as the global economy, has witnessed profound changes. The new geography of global industries, the transformation and upgrading of Chinese economy, the fast development of the Internet, and the innovation of new commercial patterns, coupled with the recent downturn in China economy, call for the integration, optimisation, and expansion of functions and innovation of policies of the current areas under special customs supervision.

In this context, the State Council published the *Notice on Distributing the Plan on Speeding up the Integration and Optimisation of Areas under Special Customs Supervision* ("the Plan") on 28 August 2015, to guide the integration and optimisation of areas under special customs supervision and propose timetables for related work. This document may not only affect traditional bonded processing, modern logistics and traditional trading businesses, but also facilitate the cross-border leasing, cross-border e-commerce, maintenance and test, and reproducing industries. Enterprises operating in related sectors in China should pay close attention to this document. We have summarised the main content of the Plan and provided our preliminary observations for your reference.

Main Content of the Plan

1. The Plan stipulates that the integration of different types of areas under special customs supervision shall be expedited, and qualified areas under special customs supervision shall be integrated and upgraded to comprehensive bonded zones. The Plan requires integrating current areas under special customs supervision and expanding their functions. In addition to continuously promoting high-end manufacturing, the state would also encourage the companies to focus on research and development, logistics, sales, repair and maintenance, and reproducing businesses, so as to increase added value, and improve the development of new technology, new products, new commercial patterns and new business modes.

2. The Plan says that the state will guide processing trade enterprises to move to midwest and northeast China, encouraging them to settle in areas under special customs supervision which cater for local industrial structure.

3. The notice clearly states that the state will adjust the tax policies for special customs supervision areas. When an area under special customs supervision successfully transforms to a comprehensive bonded zone, goods brought into the area can enjoy a VAT refund upon entrance. Enterprises in these areas can enjoy both bonded treatment and the status of a VAT general taxpayer. When bonded goods in the area are to be sold within China's territory, Customs collects the import taxes according to their status entering the trading function area, and tax bureaus collect the value-added tax according to regulations for selling products within China.

4. The notice states that the state will promote the classified supervision based on goods status and trade facilitation reform to facilitate transfer of bonded goods among areas under special customs supervision. This will enable the high-speed transfer of bonded goods among areas under special customs supervision. In addition, the storage of both bonded goods and non-bonded goods in one special customs supervision area may become reality.

5. The Plan points out that the state shall support the development of cross-border e-commerce, financial lease, bonded goods display, bonded goods delivery, reproducing and producer service sectors (such as logistics, testing/maintenance, R&D), and cultivate enterprise clusters of these industries in comprehensive bonded areas.

6. The Plan also stipulates clear timetables for related work, which increases the predictability of the policies. The Plan states that in 2015 and 2016, work is to be performed in the following areas: promoting qualified special customs supervision areas to integrate and upgrade to comprehensive bonded areas, carrying out a selective tariff collection policy for domestic sales, enhancing diversified trade pilot programs, advancing pilot programmes for classified supervision of goods status, expanding the cross-border e-commerce import business, starting pilot programs of customs supervision policy on financial leases, etc.

KPMG's Observations

1. The Plan involves many areas which have long concerned related industries. Enterprises engaging in traditional bonded processing, bonded logistics, traditional business trade, cross-border leasing, cross-border e-commerce, maintenance and test should thoroughly study the Plan and pay close attention to its implementation progress. These industries could take advantage of breakthrough development opportunities in the relevant areas. Since it takes time to go from the issuance of the Plan to its implementation in local regions, enterprises can take advantage of this lag to evaluate the Plan's effect on them from such perspectives as industry entry, customs, tax, inspection and quarantine, foreign exchange, marketing, supply chain and logistics operation to ensure fully enjoying the benefits brought by the policies and maintaining compliance at the same time.

2. The integration and transformation of special customs supervision areas to comprehensive bonded areas could have positive effects on enterprises in special customs supervision areas. Since various special customs supervision zones such as free trade zones, bonded logistic parks, export processing zones, and bonded port areas are scattered over southeast coastal regions, integrating these scattered areas is helpful to increasing both the logistic efficiency and the utilisation efficiency of these areas. Thanks to policy support, inland special customs supervision areas could also attract foreign investment and enterprises from coastal regions after integration.

3. Enterprises in special customs supervision areas can enjoy both bonded treatment and the status of VAT general taxpayer, making it convenient for the enterprises to conduct business in and out of China. However, enterprises

need to also pay attention to corresponding financial accounting treatments and tax internal controls, to avoid commingling VAT taxable business and non-taxable business.

4. High-speed transfer of bonded goods among special customs supervision areas and storage of bonded and non-bonded goods can increase logistics efficiency. For logistic enterprises and manufacturing enterprise, this means cost saving opportunities; however, enterprises should also pay attention to their internal controls over the storage of bonded and non-bonded goods in such areas to avoid unexplainable stock surpluses or shortages, and reduce the possibility of paying additional taxes or penalties to Customs.

5. Manufacturing industries should carefully consider the effects of the Plan on them. The government wants to promote the relocation of processing and trading enterprises to midwest and northwestern China, and encourage them to settle in special customs supervision areas catering to local industrial structures. However, the state will also tighten the approval to set up new comprehensive bonded area. In the future, the operating costs of an enterprise in a comprehensive bonded area may be expensive due to limited space and resources. The area may also become very crowded and affect the planning of the enterprise. In addition, the relocation of an enterprise requires comprehensive planning; in particular, the historical tax, customs and foreign exchange risks that could arise from relocation need to be controlled. Other implementation issues such as the establishment, relocation and closing of an enterprise should not be ignored.

6. The Plan is a high-level and macro plan at state level. It may still be a long waiting before detailed implementation plan and regulations come out, so affected enterprises and associations can interact with related government bodies and local authorities by giving their suggestions and insights. This should help government bodies learn and understand the major issues enterprises are facing, and create regulations conducive to the operation and business development of the enterprises.

With extensive expertise and engagement experience, KPMG's professional teams can provide consulting services in various areas, including study of special customs supervision areas and customs bonded commercial environments, project feasibility analysis and business mode comparison, customs and tax implication evaluation, supply chain optimisation, cross-border e-commerce, maintenance and testing involving special customs supervision areas.

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