

China alert

Tax and regulatory developments

TAX

August 2007, Issue 20

Paying import deposits on restricted goods under processing trade

In brief

On 23 July 2007, the Ministry of Commerce and General Administration of Customs jointly issued Notice 44, to take effect on 23 August 2007. This Notice will have a considerable impact on certain labour intensive industries, including the manufacturing of plastic raw materials and products, weaving yarn, cloth, and furniture.

Relevant regulations discussed in this issue:

The Catalogue of Merchandises Restricted from Processing Trade, 2007 Notice 44, jointly issued by the Ministry of Commerce and General Administration of Customs on 23 July 2007, effective from 23 August 2007 (Notice 44)

Notice on Reduction of VAT Export Refund Rate of Certain Goods, Caishui (2007) No. 90, jointly issued by the Ministry of Finance and State Administration of Taxation on 19 June 2007, effective from 1 July 2007

On 23 July 2007, the Ministry of Commerce and General Administration of Customs jointly issued Notice 44 which will take effect on 23 August 2007. Notice 44 will have a considerable impact on certain labour intensive industries, including the manufacturing of plastic raw materials and products, weaving yarn, cloth, and furniture. The important points are summarised as follows:

- Entities carrying out processing trade with imports or exports categorised as restricted items must pay an import deposit upon the registration of the customs logbook. The import deposit will be refunded, together with an interest, on verification of the customs logbook.
- There are two lists of restricted items:
 - The first list contains 394 items of restricted importing items which were announced prior to 2007
 - The second contains 1,853 items of newly announced restricted exporting items, most of which are plastic raw materials, weaving yarn, cloth, furniture, and metal products.
- The methods of calculating the import deposit amount are different. The calculation depends on (1) the grading of the entity and (2) which restricted item list the goods fall into.

- Importing restricted importing Items

$$\text{Importing deposit} = \text{CDT} \times \text{PCT}$$

CDT: The customs duty and import VAT payable for the value of restricted importing items

PCT: either 50% for grade A or B entities or 100% for grade C entities

- Exporting restricted exporting items

Import deposit = $VBM \times (VER / TVE) \times WR \times PCT$

VBM: value of bonded materials to be imported in the customs logbook

VER: Value of exports on the list of restricted exporting items

TVE: Total export value of goods in the customs logbook

WR: weighted rate

The weighted rate is 22%, and can be adjusted in the future

PCT: either 50% for grade A or B entities or 100% for grade C entities

- Import and export both falling within the list of restricted items

Importing deposit = $CDT \times PCT$

CDT: The customs duty and import VAT payable for the value of restricted importing items

PCT: either 50% for grade A or B entities or 100% for grade C entities.

- Grade A or grade B entities set up in the central and west of China are not required to pay the import deposit. Areas other than the 10 provinces / municipalities of eastern China are considered as west and central. The eastern area covers: Beijing, Tianjin, Shanghai, Liaoning, Hebei, Shandong, Jiangsu, Zhejiang, Fujian and Guangdong.
- Enterprises under the Customs Online Supervision System (COSS) in eastern China are affected by Notice 44.
- There is a transitional period. For those entities importing by customs logbooks, the new rule will apply on registration of the new logbooks. For those entities supervised by Customs on an entity basis (e.g. those under COSS), there will be a one-year transitional period until 23 August 2008.
- Entities set up in Export Processing Zones and Free Trade Zones are not affected.

Contact us

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Illustration of the effect

We will illustrate the effects of the new rules on a grade A or grade B enterprise.

To export a single product; for example, USD 500,000 of cotton towels (HS code: 6302 9100 20) within six months in one customs logbook.

The enterprise needs to import USD 300,000 of raw materials to make the cotton towels.

Import deposit payable on registration of customs logbook
= USD300,000 x 22% (weighted rate) x 50% (for an A or B grade entity)
= USD 33,000

How are companies affected?

Manufacturers of items on the lists of restricted items will face great financial pressure in order to finance the import deposit. In general, the more the amount registered in the customs logbook, the more the amount of the import deposit will be. The longer the period covered by the customs logbook, the longer import deposit will be held by the Customs. In addition to the import deposit, the VAT refund rates of most of these items were reduced from 1 July 2007. That means a significant increase of cost on related exports from China.

This matches the policy of discouraging production of low value-added and low technology goods, and goods with a large trade surplus.

Existing manufacturers should assess the effects the latest change will have on the cost of products and consider the possibility of changing the mode of operation and the supply chain. Potential investors should evaluate China's industrial policy and consider appropriate areas or special bonded zones for production.

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