

Asia Pacific Trade & Commerce Client Conference

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Trade

China

1. Customs

Reduced Tariffs

China announced provisional tariffs for selected apparel, clothing accessories and footwear. The provisional tariffs, effective from 1 January 2016, would effectively reduce the import customs duty for these products by approximately 50%.

Free Trade Agreements

China's latest free trade agreements with Australia and South Korea respectively came into force on 20 December 2015 upon approval by the State Council.

Increased Import Tax Rates for Personal Articles

The Tariff Committee of the State Council amended the schedule of Personal and Postal Article Tax (“PPT”), which is an import tax designed to facilitate importation of personal articles through postal and courier services or carry-on luggage. The new PPT schedule, effective from 8 April 2016, provides for substantially higher PPT rates than the previous schedule. For example, the PPT for cosmetics was increased from 50% to 60%, apparel from 20% to 30%, and food from 10% to 15%.

By increasing PPT rates, China Customs intends to regulate the booming e-commerce retail businesses by diverting the sales through grey imports to the approved and closely supervised e-commerce channels.

Customs Facilitation

As an initiative launched in 2014 to integrate regional customs

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clearance, localities with close economic relations are treated essentially as one integrated port, allowing customs brokers and enterprises to freely choose which customs district it clears goods through, regardless of where they are registered. As of now, such integrated “regions” include the Silk Road Economic Belt, the Yangtze River Economic Belt, Northeast China, Guangdong Area and Beijing, Tianjin and Hebei Area.

Effective from 29 September 2015, the General Administration of Customs (“**GAC**”) promulgated Circular [2015] No. 47, to extend this reform to special bonded areas. As a result, imports and exports into and out of the special bonded areas (such as bonded logistics parks, bonded port zones, export processing zones) can also be cleared through customs districts freely chosen by the customs brokers and enterprises, so long as such districts are located in the same integrated regions as the special bonded areas.

With the issuance of GAC Circular [2015] No. 55, the paperless customs clearance reform has been extended to procedures relating to amendment or revocation of previously filed customs declaration forms.

GAC issued a regulation under Circular [2015] No. 52, effective 30 October 2015, to implement the Mutual Recognition Arrangement (“**MRA**”) of Authorized Economic Operators (“**AEO**”) between the European Union and China, as amended in June 2015. Under this regulation, a European AEO only needs to report its Economic Operators Registration and Identification (“**EORI**”) number on the import customs declaration form filed by its Chinese importer for each shipment into China, in order to be entitled to the benefits under the MRA.

Upgrading of Special Bonded Areas

On 28 August 2015, the State Council issued the Notice Guo Ban Fa [2015] No. 66, to announce the central government’s commitment to upgrade the existing special bonded areas in China. The policy goal is to integrate the functions of the different types of bonded areas, including bonded zones, bonded logistics parks, bonded port zones, and export processing zones, and upgrade them into “integrated bonded zones”.

The upgraded zones are said to have functions involving manufacturing, sales, foreign exchange settlement, logistics, testing and repair, and research and development. The reform initiative will first be launched in the existing Pilot Free Trade Zones (“**FTZs**”) in Shanghai, Tianjin, Guangdong and Fujian, as well Suzhou and Chongqing, and replicated in other special bonded areas before 2018.

As part of the effort to meet the above policy objectives, GAC issued a new regulation under Circular [2015] No. 59, effective from 11 December 2015, which allows companies registered in

all special bonded areas across the country to perform bonded repair services for products originating in either China or a foreign country. Under the previously regulations, only the made-in-China products are allowed to be repaired in the special bonded areas.

Bonded Manufacturing Reform

According to GAC Circular [2015] No. 53, effective from 5 November 2015, companies operating under the bonded manufacturing or “processing trade” program are now allowed to choose between the traditional method and the new “work order-based” method to complete the inventory reconciliation, which is an exercise required by customs on a periodical basis to ensure that none of the duty-bonded goods or materials are sold domestically without approval.

The new reconciliation method does not require reporting of bill of materials (“**BOM**”) to customs, and hence would substantially reduce the risk of discrepancy. Nevertheless, it requires a revamp of the company’s existing inventory system in order to be compatible and interconnected with the customs system. For this reason, this new method has not been widely used by companies.

In the Notice Guo Fa [2016] No. 4 issued by the State Council on 4 January 2016, the central government is committed to further optimizing the reconciliation method and simplifying the approval for bonded manufacturing operations and domestic sales of duty bonded goods.

New Customs Declaration Requirements for Related Party Transactions

Pursuant to GAC Circular [2016] No. 20 (“**Circular 20**”), effective from 30 March 2016, GAC amended the types of information that importers and exporters are required to provide when making customs declarations. Among the various additional items, the following items are of particular concern:

- (1) Whether there is special relationship between the buyer and seller in the transaction;
- (2) Whether the special relationship has influenced the transaction value; and
- (3) Whether there are any royalty payments related to the goods sold.

Nevertheless, these new reporting requirements are not entirely consistent with the requirements in the *Measures of Customs of the People’s Republic of China on Determining the Dutiable Value of Imports and Exports*, issued under GAC Order No. 213 (“**Order 213**”), which is China’s customs valuation regulation in

conformity with the WTO Valuation Agreement.

In particular, pursuant to Order 213, customs may determine whether the relationship has influenced the transaction value by either “examining the circumstances of the sale”, or comparison to certain “test values”. In contrast, Circular 20 requires companies to report whether there is such an influence based entirely upon the “test value” method.

Circular 20 is also silent as to whether the royalty payments need to be a condition of sale of the goods by the seller to the buyer, which is one of the elements for establishing dutiable royalty payments under Order 213, in order to trigger the reporting obligations in the new customs declaration forms.

These new reporting items would enable customs to increase scrutiny over the customs valuation of goods. This is a continuation of the trend toward more aggressive customs audits and investigations in China, especially in relation to related party transactions.

Enforcement

According to the statistics released by GAC, from January to November 2015, the customs offices throughout China had dealt with 2,088 smuggling cases which include 1,168 tax related criminal smuggling cases, involving tax evasion amounting to RMB 8.84 billion.

2. Export Control and Trade Sanction

On 5 April 2016, GAC and the Ministry of Commerce (“MOFCOM”) jointly issued Circular [2016] No. 11, aimed at implementing the new sanctions against the Democratic People’s Republic of Korea (“DPRK”) adopted by the United Nations Security Council (“UNSC”) in Resolutions 2270 (2016) and 2276 (2016) in March 2016.

Nevertheless, this circular only provides for measures that prohibit transfer of certain mineral and gasoline products between China and DPRK. On the other hand, sanctions involving other products, such as “luxury goods”, which were included in earlier UNSC resolutions, but reaffirmed by the recent two resolutions, have yet to be incorporated into domestic law by China. As a result, it remains to be seen how these sanction measures would be enforced by the Chinese government.

Commerce

China

3. E-commerce

New Regulations for Cross-border E-commerce Sales

GAC and China's top product regulatory authorities jointly published a set of new regulations in April 2016, to revamp China's cross-border e-commerce retail program ("**Program**") that has been piloted since early 2014, which was designed to facilitate sales of qualifying consumer goods by foreign companies directly to Chinese customers through the approved e-commerce platforms.

The new regulations have two major implications: (1) they impose new tax rates for sales under the Program; and (2) they change the Program from a negative list regime to a "positive list" regime for product regulatory purposes.

From a tax perspective, The qualifying imports under the Program are now subject to import VAT and consumption tax (if applicable) under the China tariff schedule, but the taxes are collected with a 30% discount. For example, body care products are subject to an import VAT of 17%, but the consumption tax is inapplicable. As a result, the actual import tax rate, after applying the 30% discount, would be 11.9%. Compared with the PPT rate (currently 30%) previously imposed on the e-commerce imports before the issuance of the new regulations, the duty saving benefit of the Program has increased, so far as this particular product category is concerned.

Notwithstanding the reduced import tax, the tax exemption policy under the old regulations, whereby the import tax would be exempted if the tax payable does not exceed a certain threshold amount, would no longer be available under the new regulations.

The new regulations have increased the value limit for each consignment of goods that would qualify for the benefit of the Program from RMB 1,000 to RMB 2,000 (approximately USD 310). In the meantime, an annual quota of RMB 20,000 (approximately USD 3,100) is imposed on the qualifying goods that each Chinese resident is allowed to import.

From a product regulatory perspective, only the products listed as "permitted" on the "positive list" can be imported under the Program. While the two "positive lists" published in April 2016 have basically covered all consumer products, they also contain certain "notes", which provide that certain registration or licensing requirements be fulfilled, and the commodity inspection and quarantine procedures be followed, in order to import the products into China through the e-commerce channel. These provisions have to a large extent equalized the product regulatory requirements applicable to the e-commerce sales and the ordinary trade transactions. The products most substantially impacted by these new provisions include cosmetics, health food and infant milk formula.

Technically speaking, the consumer goods sold on offshore websites not approved by China Customs and imported through the traditional channels of postal or courier services should remain classified as “personal articles”, which are outside the scope of the Program and not governed by the above e-commerce regulations. Nevertheless, these imports might also be subject to delay or heightened inspection as a result of the new regulations, as the Chinese government intends to divert the sales from the unregulated foreign websites to the approved and closely supervised e-commerce platforms.

New E-commerce Comprehensive Trial Zone

Following the establishment of the first cross-border e-commerce pilot zone in Hangzhou in March 2015, which is home to Alibaba, the State Council announced the launch of 12 additional e-commerce pilot zones in major cities of China, including Shanghai, Tianjin, Shenzhen, Guangzhou, Chongqing, Hefei, Chengdu, Dalian, Ningbo, Qingdao and Suzhou, effective in January 2016. Similar to the Hangzhou trial zone, the new trial zones will also be dedicated to new reform initiatives aimed at setting technical standards and optimizing business process and regulatory supervision for B2B cross-border e-commerce transactions.

4. Cybersecurity

China has a fast pace on cybersecurity law making. Following the promulgation of new National Security Law and the release of the draft Cybersecurity Law for public comments in July 2015, the Anti-Terrorism Law of the People’s Republic of China (“**Anti-terrorism Law**”) was passed by the Standing Committee of the National People’s Congress and became effective on 1 January 2016.

As far as the cyberspace is concerned, the Anti-terrorism Law imposes three specific obligations on “telecom business operators” and “Internet service providers”:

- (1) to provide technical support to authorities in their efforts to combat terrorism, specifically, provide technical interface in the network or decryption assistance as may be requested on the occasion;
- (2) to adopt appropriate security measures, monitor and prevent dissemination of terrorist or extremist content, and cooperate with government investigations;
- (3) to verify customer identity and refrain from serving customers who fail to pass identity check.

Companies will be fined for non-compliance in an amount between RMB 200,000 to 500,000. In serious cases, however, a higher fine can be imposed, possibly along with an order to

cease operation. It is noted that directly responsible individuals will also be subject to penalties, which in serious cases include fines up to RMB 500,000 and administrative detention up to 15 days.

Enforcement of the Anti-terrorism Law is led by the Ministry of Public Security and the Ministry of National Security, under the direction of the National Anti-terrorism Leadership Group, and assisted by the judiciary, the army and the police.

5. New Consumer Products Recall Rules

China formalised product recall procedures under the new *Administrative Measures for Recall of Defective Consumer Goods*, AQSIQ Announcement No. 151 of 2015, which came into effect on 1 January 2016. Previously, China only had specific product recall regulations for automotive products, toys, medical devices, food, drugs and railway equipment, but this new regulation formalises product recall procedures and requirements for other consumer goods. “Consumer goods” is defined broadly to include products purchased by consumer used for daily life and consumption.

The regulations apply where defects are found in consumer goods. Such defects refer to non-compliance with China’s national or industrial standards that protect safety and property, and covers defects in design, manufacturing and even warning labels, that cause “unreasonable danger”. The onus of conducting recalls is placed on the manufacturer, and in the case of imported goods, the importer takes the role of the manufacturer for the purposes of these regulations.

Manufacturers are obliged to report defects that warrant a product recall to the provincial Quality Supervision Department. Members of the public also have standing to report consumer goods defects to these departments, which are to be investigated so that a decision on whether to issue a recall instruction can be taken. “Possible defects” must be investigated, and confirmed defects must lead to a cessation in the production, sales or import of such defective consumer goods. Manufacturers are given the opportunity to oppose or appeal the government’s instructions to conduct product recalls.

Aside from manufacturers, the regulations also place an obligation on distributors, lessors, repairers, component suppliers and contract manufacturers to report “possible defects” to the provincial Quality Supervision Department, and to cease dealing with such defective consumer goods.

6. Old Mechanical and Electric Products

China has been overhauling the regulations concerning old mechanical and electric (“**M&E**”) products importation since December 2014, with the issuance of AQSIQ Circular [2014] No.

145, which removed the requirement for pre-importation recordal, and reclassified the old M&E products based upon the new restrictive measures imposed. Such measures now only include import prohibition, pre-shipment inspection, and arrival inspection.

On 23 November 2015, the Administration of Quality Supervision, Inspection and Quarantine (“**AQSIQ**”) issued a new overarching regulation on old M&E products importation under AQSIQ Order No. 171, entitled *Supervision and Administration Measures on Imported Old Mechanical and Electric Products*. This regulation, effective from 1 January 2016, replaces the previous regulation with the same title issued in December 2002, and has reflected the recent changes of the regulatory measures.

7. Duty-Free Shops

Ministry of Finance, MOFCOM, State Administration of Taxation, GAC and National Tourism Administration jointly issued two regulations under Circular [2016] No. 8 and Circular [2016] No. 19, both effective from 18 February, which provide for establishment and operation of duty free retailing businesses at ports of entry.

According to these regulations, 19 additional airports and inland ports of entry have obtained approval from the State Council to open duty-free shops. A duty free shop at the port of entry must be majority-owned by a company specially licensed by the central government for duty free retailing.

Product sold in the duty free shops are to be hand-carried by a passenger as personal belongings into China, and exempt from any customs duty or import tax. The value limit for all duty free products that a passenger can carry into China per entry is RMB 8,000, regardless of whether they are purchased outside of China, or in a duty free shop at the port entry.

The new regulations also contain a “positive list” of products that are allowed to be sold at the duty free shops, which largely include food, cosmetics, apparel, footwear and clothing accessories, home use medical devices, infant formula, cigarette, alcohol and baby diapers.