

2.3 Processing Trade

Processing trade refers to the business activity of importing all or part of the raw and auxiliary materials, parts and components, accessories, and packaging materials from abroad in bond, and re-exporting the finished products after processing or assembly by enterprises within the mainland. It includes processing with supplied materials and processing with imported materials. Under processing with supplied materials, the imported materials and parts are supplied by the foreign party which is also responsible for selling the finished products. The business enterprise does not have to make foreign exchange payment for the imports and only charges the foreign party a processing fee. Under processing with imported materials, the business enterprise makes foreign exchange payment for the imported materials and parts and exports the finished products after processing.

2.3.1 Examination and Approval of Processing Trade

(a) Business Enterprises and Processing Enterprises

According to the *Interim Measures for the Administration of Examination and Approval of Processing Trade*, approval from provincial-level commerce departments must first be sought for business enterprises to engage in processing trade (including processing with supplied materials and processing with imported materials). Business enterprises refer to import-export enterprises and FIEs responsible for signing processing trade import-export contracts with foreign parties, as well as processing and assembly service companies that are granted permission to undertake processing with supplied materials. Processing enterprises refer to production enterprises with legal person status that process or assemble imported materials and parts for business enterprises, or factories established by business enterprises but with no legal person status and yet practise independent accounting and have their own business licence.

(b) Examination and Approval Organ

For business enterprises (including corporations and their subsidiaries which are formerly under various ministries and commissions) planning to engage in processing trade that use cotton, sugar, vegetable oil, wool, natural rubber, crude oil or refined oil (which are subject to tariff-rate quota management) as raw materials, approval has to be sought from the provincial-level commerce authorities at the place of their registration. Other processing trade activities only require the approval of commerce authorities in the place of registration of the business enterprises (which may be departments at prefecture, city or county level authorised by the provincial-level commerce authorities).

(c) Documentation for Application

- A written report by the business enterprise in support of its application and a completed Processing Trade Application Form bearing its stamp.
- Photocopies of the Filing and Registration Form of the business enterprise bearing the seal of and issued by the Ministry of Commerce (or FIE approval certificate) and its business licence.
- Original copy of the document issued by the commerce authorities at or above county level at the place of registration of the processing enterprise certifying its production capacity, and photocopy of its business licence.
- Original copy of the import-export contract signed by the business enterprise with foreign parties.
- Original copy of the processing trade agreement (contract) signed between the business enterprise and the processing enterprise.
- Other documents and materials deemed necessary by the approval organs.
- If the business enterprise or processing enterprise is an FIE, it is also necessary to submit relevant contracts

and articles of association approved by the commerce authorities stipulating the business scope and production scale of the enterprise, as well as documents proving that the production facilities have been completed and put into operation, that investment is already in place and that the enterprise has passed the necessary annual inspections.

- For processing trade using imported scrap metals or other wastes as materials, an import approval document issued by the State Environmental Protection Administration in accordance with the relevant regulations is required. In the case of processing trade where the import of materials or export of finished products involve chemicals which may be used for the production of dangerous drugs or chemicals for both civilian and military use, an approval document issued by the departments concerned is required.

(d) Approval of Processing Trade Activities (Contracts)

Processing trade approval organs under the commerce authorities will issue a Processing Trade Approval Certificate stamped with the processing trade approval seal to business enterprises that have submitted the required documents and have proven their ability to process the imported materials and re-export the finished products. This certificate is a valid document for the opening of customs duty deposit accounts with Customs and other departments. The approval organ will examine and verify the unit consumption declared by the enterprise and prepare the "Checklist for the Filing of Imported Materials" and "Checklist for the Filing of Finished Products for Export and Corresponding Consumption of Imported Materials". These checklists, stamped with the processing trade approval seal, are issued to enterprises for the filing of contracts with Customs.

2.3.2 Customs Supervision

(a) Filing and Registration

Upon obtaining approval from the commerce authorities to engage in processing trade, a business enterprise should present the Processing Trade Approval Certificate and processing trade contract to the customs office where the processing enterprise is located to complete the filing and registration formalities and to apply for the Processing Trade Registration Handbook. The processing enterprise should complete its registration and register its code at the local customs office. For processing trade business enterprises that also engage in processing activities (including FIEs with import-export rights), their customs registration codes as business enterprises are their codes as processing enterprises as well. There is no need to go through separate registration formalities.

(b) Import-Export and Processing of Goods for Processing Trade

Business enterprises may import goods for processing trade from abroad or from special areas or export warehouses under customs supervision. They may also do so by transfer-in for deep processing.

Business enterprises may export goods for processing trade overseas or to special areas or export warehouses under customs supervision. They may also do so by transfer-out for deep processing.

Business enterprises must complete customs declaration formalities for the import-export of goods for processing trade by presenting the processing trade handbook, Special Customs Declaration Form for Import-Export of Goods in Processing Trade, and other relevant documents.

(c) Bonded Supervision

- Bonded system. Under the system of processing trade administration, Customs allow enterprises in China to defer payment of tariffs and import-related taxes on all

materials and parts imported, whether they are purchased with foreign exchange or supplied by foreign customers. The amount of imported materials and parts actually used in the making of the finished products for export is exempt from tariffs and import-related taxes. For bonded materials and parts imported for processing or finished products which are allowed to be sold in the domestic market, Customs will levy duties and interest on deferred payment on the bonded materials and parts based on valid approval documents for domestic sale issued by relevant departments. If the bonded materials and parts are under import restriction, the business enterprise must also submit the import licence to Customs. All processed finished products for export are exempt from export tariffs.

- Full bond. Full bond is extended to the import of materials and parts by bonded factories and warehouses, the import of materials and parts under counterpart export processing contracts, as well as the import of materials and parts supplied by foreign clients.
- Fixed rate levy. For processing with imported materials not involving bonded factories, bonded warehouses or counterpart contracts, the materials and parts imported are bonded at the rates stipulated in the *Scale for Tax Levy and Exemption on Imported Materials and Parts in Processing with Imported Materials*. The scale of tax levy and exemption is indicated in the Processing Handbook issued by Customs.
- Full levy and export rebate. Enterprises which have violated customs regulations or failed to complete the verification and cancellation formalities for prolonged periods are required to pay full tax on the imported materials and parts at the time of import. They may apply to Customs at the place of tax payment for rebates on materials actually used after the imported materials have been processed and the finished products re-exported.

- Management of enterprises by category. China adopts the customs duty deposit system on processing trade enterprises. Under this system, commodities imported for the processing trade are classified into prohibited, restricted and permitted, while processing trade enterprises are classified under four categories, namely A, B, C and D. Category A enterprises are bonded factories with no records of smuggling or violation of customs regulations, with customs officers posted on-site and online links established with the customs office; they also include processing enterprises engaged in such special trades as aircraft or ship building. Category B enterprises are those confirmed by Customs to have no record of smuggling or other violations. Category C enterprises are those confirmed by Customs to have records of violation of regulations; while Category D enterprises are those confirmed by Customs to have records of smuggling or at least three counts of violation of regulations. The Ministry of Commerce publishes a catalogue of commodities subject to management by category and a list of Category A, C and D enterprises. Category B enterprises are not listed.
- Customs duty deposit system
 - Materials and parts imported by Category A enterprises, bonded warehouses, bonded areas, and enterprises in export processing zones for processing trade are exempt from customs duty deposit payment. Qualified processing trade enterprises may apply to Customs for permission to establish bonded factories. Business enterprises and processing enterprises may apply to Customs for permission to establish bonded warehouses for the storage of imported materials and parts for processing.
 - Category B enterprises are required to make “nominal” payment of customs duty deposit. Business enterprise should open a customs duty deposit account with the Bank of China (BOC) where the processing enterprises are located by

presenting a Customs Duty Deposit Account Opening Form issued by the local customs. Upon opening the account, BOC will issue a Customs Duty Deposit Account Registration Notice, which the business enterprise will submit to the local customs for the registration of processing trade contracts. The enterprise does not have to pay customs duty deposit even though an account has been opened.

- For processing trade involving restricted commodities and for Category C enterprises, "actual" payment of customs duty deposit is required. Customs duty deposit has to be paid into Customs' special account at BOC. After an enterprise has processed and exported the goods and completed the verification and cancellation procedures within the stipulated time, BOC will refund the deposit to the enterprise upon presentation of the account cancellation notice issued by Customs, with interest paid at call rate. If an enterprise cannot process and export the goods or obtain approval for domestic sales within the term stipulated in the contract, Customs will notify BOC to have the deposit and interest converted into tax payment and interest on deferred payment respectively. If an enterprise cannot pay the deposit, it may apply to BOC to open a letter of guarantee with Customs as the beneficiary. If it cannot obtain a letter of guarantee, it must pay the deposit in cash or by cheque, money order or remittance. Upon receipt of the letter of guarantee or deposit, the Customs Duty Deposit Department of BOC will issue a Customs Duty Deposit Account Registration Notice or Customs Duty Deposit Account Alteration Notice to the enterprise to be presented to Customs together with the letter of guarantee and other documents for filing the contracts.
- As for Category D enterprises, the commerce authorities will revoke their processing trade rights.

(d) Customs Declaration

- Import-export declaration. Business enterprises must make import-export declaration to Customs by filling out their Registration Handbook and Special Customs Declaration Form for Import-Export Goods for Processing with Imported Materials (i.e. Special Customs Declaration Form), and presenting these together with the relevant bills of lading, freight notes, packing lists and invoices.
- Inspection. At the time of inspection by Customs, the customs declaration personnel of the enterprise must be present, who is responsible for moving, opening and repacking the goods on the instruction of customs officers.
- Payment of tariffs and charges. Enterprises are required to pay charges for the safekeeping of materials and parts imported in bond under customs supervision. For goods subject to fixed rate bond and full levy, tax must be paid in accordance with the rate indicated on the customs declaration form. No tax is levied on goods in full bond or on goods re-exported after processing.
- Release of goods. Customs will stamp the "Release" seal on the relevant freight documents and one of the customs declaration forms after completing the necessary formalities.

(e) Verification and Cancellation of Export

- Time limit for reverse export of finished products
For reverse export, business enterprises must process the imported materials, export the finished products, and complete the verification and cancellation procedures within the time limit stipulated in the Processing Trade Approval Certificate. In general, the reverse export time limit for the finished products is no more than a year. For processed sugar, cotton, vegetable oil, wool and natural rubber, the time limit is normally no more than six months. If the time limit needs to be extended for special reasons, permission

must be sought from the original approving organ before applying to Customs for an extension. Under normal circumstances, extension will not be granted on more than two occasions and each extension will not last more than six months.

- Verification and cancellation procedures

Within one month after completion of an export contract, the business enterprise should, upon approval from the commerce authorities, proceed to Customs for verification and cancellation procedures by submitting its Registration Handbook, Special Customs Declaration Form, List of Imported Materials and Parts Used, and other relevant documents. For contracts under the customs duty deposit system, a Customs Duty Deposit Verification and Cancellation Form must first be obtained from Customs, upon presentation of which the bank will issue a Customs Duty Deposit Verification and Cancellation Notice, and with this notice Customs will complete the verification and cancellation procedures. Within 30 days after verification and cancellation of the export, the enterprise should submit the Verification and Cancellation Notice issued by Customs to the original approving organ for verification and cancellation of the record. For enterprises storing their processed goods in export warehouses under customs supervision or in bonded areas, they should complete the verification and cancellation procedures with Customs by presenting the receipt issued by the customs office at the warehouse or bonded area, and complete the verification and cancellation procedures in connection with their customs duty deposit account with the bank by presenting the documents issued by the customs office.

2.3.3 Domestic Sale of Materials, Parts and Finished Products

Materials and parts imported in bond must be re-exported after processing, and enterprises may not sell their bonded materials and parts or finished products in China. If such goods have to

be sold on the domestic market for special reasons, approval must be obtained from the commerce authorities in charge of processing trade at provincial level as well as Customs. Business enterprises and processing enterprises must promptly pay the tariffs and VAT exempted on the imported materials and parts if these goods are sold domestically, whether the import settlement is in renminbi or in foreign currency. For commodities subject to import restriction or import licensing, enterprises should apply for approval in arrears from the authorities concerned and obtain the necessary import approval documents or import licence. The commerce authorities in charge of processing trade at provincial level will verify the enterprise's application and import licence issued by relevant import administration organs and issue a Domestic Sale Approval Certificate for Bonded Materials and Parts for Processing (i.e. Domestic Sale Approval Certificate), specifying its corresponding import licence name and number in the "remarks" column. With this Domestic Sale Approval Certificate and the valid licence whose number is specified therein, Customs will proceed with taxation for domestic sale and verification and cancellation procedures in connection with processing trade. If the enterprise is unable to submit the import licence issued by the relevant import administration organ, the commerce authorities in charge of processing trade at provincial level may still issue the Domestic Sale Approval Certificate once Customs proceed with the verification and cancellation of the processing trade handbook after levying on the enterprise duties and interest thereon and a penalty ranging from 30% to 100% of the declared value of the imported materials and parts.

2.3.4 Transfer of Bonded Goods for Deep Processing

If a business enterprise wishes to transfer its processed bonded goods to another processing trade enterprise for deep processing and re-export, it must seek approval from the commerce authorities and complete the necessary customs formalities before making the actual transfer. Unprocessed bonded materials and parts may not be transferred.

To transfer bonded goods to another enterprise for deep processing, the transfer-out enterprise, after obtaining its Registration Handbook, should submit its transfer plan to Customs by presenting the Transfer of Bonded Goods for Deep Processing Application Form. Upon approval granted by the local customs where the transfer-in enterprise is located, the goods may be transferred in batches. In completing customs transfer procedures, the transfer-in enterprise has to re-register the contract with its local customs and open a customs duty deposit account with a designated branch of BOC. The transfer-out enterprise should complete the customs transfer procedures for the intermediate goods with its local customs by presenting the Registration Handbook issued by the local customs where the transfer-in enterprise is located. Subsequently, the transfer-out enterprise should go through the contract and customs duty deposit account verification and cancellation procedures with its local customs by presenting the receipt issued by the customs office where the transfer-in enterprise is located.

2.3.5 Cross Customs Area Processing

In the case where a business enterprise wishes to commission the processing of imported materials and parts to a processing enterprise in a different customs area, both parties must submit their transfer plans to their respective customs offices by presenting the Transfer of Bonded Goods for Deep Processing Application Form and, upon filing, complete the actual transfer and customs declaration formalities.

Within 20 days from filing with the customs where the transfer-out enterprise is located, the transfer-in enterprise must complete the registration procedures with its local customs by filling out and presenting the Application Form. If the transfer-in enterprise fails to submit the Application Form within 20 days or fails to obtain Customs' approval due to contents of the Application Form not meeting customs requirements, the Application Form will be invalidated and both the transfer-in and transfer-out enterprises must submit their applications and register anew.

After the actual transfer, both the transfer-in and transfer-out enterprises must complete the customs declaration procedures with their respective customs offices by presenting an Application Form covering the goods in batches or in one lot within 90 days of the transfer. If each and every batch of goods, the transfer-in enterprise should declare with its local customs for import of the transferred goods by presenting the Application Form and Registration Form and notify the transfer-out enterprise on the following working day. Within 10 days from the receipt of the notification, the transfer-out enterprise must declare with its local customs for export of the transferred goods by presenting the Application Form and Registration Form.

2.3.6 Tax Exemption Procedures

An export enterprise should, after importing raw and auxiliary materials, parts and components, apply to the tax department in charge of export rebates for "tax exemption proof" by presenting its import customs declaration form and Registration Handbook.

With this proof, it can apply to the tax department in charge of tax collection for exemption of VAT and consumption tax on processing trade. If processing is commissioned to other enterprises, the "tax exemption proof" should be passed to the processing enterprise to apply for VAT and consumption tax exemption. After exporting the processed goods, the export enterprise should proceed to the tax department in charge of export rebates to complete the verification and cancellation procedures by submitting the export customs declaration form, the Registration Handbook already verified and cancelled by customs, and the foreign exchange receipt slip. If it fails to complete the verification and cancellation procedures before the time limit, the tax department in charge of export rebates, the tax collection department and Customs will jointly demand tax payment and impose penalties.

2.3.7 Quota and Licensing Control

(a) Quotas and Licences for Imported Materials and Parts

With the exception of refined oil products, classified chemicals, poisonous chemicals and CR-ROM manufacturing equipment, the import of commodities subject to licensing control for the processing trade is exempt from import licence. For the import of classified chemicals, it is necessary to obtain an import licence by presenting the Classified Chemicals Import Approval Form issued by the Office of the Working Group on Fulfilment of the Treaty on Banning Chemical Weapons of the State, as well as the import contract (original and copy). For the import of poisonous chemicals, it is necessary to obtain an import licence by presenting the Poisonous Chemicals Import Approval Form issued by the Ministry of Commerce, as well as the import contract (original and copy). For the import of CD-ROM manufacturing equipment, it is necessary to obtain an import licence by presenting the approval documents issued by the State Press and Publication Administration, as well as the import certificate for mechanical and electronic products issued by the Ministry of Commerce. Quota certificates are issued by the Special

Commissioner's Offices and Bureau of Quota and Licence Affairs under the Ministry of Commerce.

Furthermore, quotas must be obtained for the import of commodities subject to tariff-rate quota management at the quota tariff rates.

(b) Domestic Sale of Imported Materials and Parts

If the imported materials and parts granted approval for domestic sale are subject to import restriction or licensing, the enterprise should apply for approval in arrears from the authorities concerned.

(c) Export of Finished Products

If the finished products of processing with imported materials are subject to export quota control, the business enterprise must seek approval from the commerce authorities before signing the contract. After obtaining the export quotas, it can apply for an export licence by presenting the export quota certificate and the Processing Trade Approval Certificate, which must be submitted at the time of customs declaration. The export of products processed with supplied materials or assembled with supplied parts is exempt from export licence but is subject to customs supervision.

2.3.8 Online Supervision of Processing Trade

With a view to strengthening supervision of processing trade by means of modern management methods and facilitating the development of new and high technology industries, the former MOFTEC and General Administration of Customs (GAC) jointly promulgated the *Interim Measures for the Administration of Online Supervision and Approval of Processing Trade Enterprises* on 25 October 2001. The measures provide a simplified framework for the administration of enterprises participating in the online system.

According to the measures, these "online enterprises" engaged in processing trade are exempt from the customs duty deposit

system. The commerce authorities would no longer examine and approve their processing trade contracts and would only appraise their qualification for carrying out processing trade, business scope and processing capabilities.

Online enterprises applying for permission to engage in processing trade should submit to the commerce authorities their financial proofs and application materials. These include: business licence (copy), approval certificate of online enterprise issued by Customs, Registration Form for import-export rights or FIE approval certificate (copy), record of passing the joint annual appraisal (except newly established enterprises without such record), original of processing trade enterprise production capability certificate issued by the local commerce authorities at county-level or above, proof of the online enterprise's export performance in the previous year (copies of customs declaration forms or processing trade contract verification/cancellation forms), brief description of the enterprise and the raw materials and parts it imports and the products it exports, and checklist of business scope.

Upon receipt of an online enterprise's application, unless the processing trade activities involved are prohibited by the state, otherwise the commerce authorities would grant approval and issue an approval certificate to the online enterprise to engage in processing trade. Based on this certificate, Customs will set up a processing trade electronic account for the online enterprise concerned and implement online supervision. The online enterprise may then import raw materials and parts and export products within the approved scope.