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. An operation enterprise in processing trade 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 operation enterprise makes foreign exchange payment for the imported materials and parts and exports the finished products after processing.

Operation enterprises in processing trade 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 given the right to sign processing contracts with foreign parties.

Processing enterprises in processing trade refer to production enterprises with legal person status that process or assemble imported materials and parts for operation enterprises, or factories established by operation enterprises but with no legal person status and yet practise independent accounting and have their own business licence.

Administration of Processing Trade

China used to implement an approval system on operation enterprises of processing trade (including processing with supplied materials and processing with imported materials). As a result of ongoing reforms of its administrative approval systems in recent years, the approval requirements for processing trade have been abolished across the country. Processing trade is, instead, administered through the measures governing the applications for the Certificate of Production Capacity of Processing Enterprise in Processing Trade and the record filing of processing trade operation.

(a) Obtaining the Certificate of Production Capacity of Processing Enterprise in Processing Trade

Enterprises should make an application at MOFCOM’s certification system of enterprise operation status and production capacity (http://jmsa/ec.com.cn/jmdc/) by uploading the required materials. Upon receipt of the online application, the approval organs will examine the materials provided by the enterprises. Applications providing correct information and meeting the criteria will be approved and endorsed, whereas those failing to meet the criteria will be rejected with explanation of the decision given, and the reasons for rejection will also be filed in the system. Upon approval, the enterprise can print out the completed application form for the certificate of production capacity and
bring the form together with all the required materials to a service counter of the local commerce department for stamping an official seal and for collecting the Certificate of Production Capacity of Processing Enterprise in Processing Trade.

(b) Documents and Materials Required for Application

- A completed application form for the certificate of production capacity.
- Photocopy of business licence.
- Photocopy of the social security payment receipt or proof.
- Other supporting documents and materials.

Customs Supervision

(a) Issuance of Processing Trade Goods Handbook

After obtaining the Certificate of Production Capacity of Processing Enterprise in Processing Trade issued by the commerce department or the management committee of special customs supervision area, enterprises embarking on processing trade should go to Customs within the validity period of the Certificate and complete the formalities for obtaining a Processing Trade Handbook. Customs will issue the Handbook based on the scope of tax items (the first four digits of the commodity codes) listed in the Certificate of Production Capacity of Processing Enterprise in Processing Trade, and no further verification of the related licences is required. For the processing trade involving prohibited or restricted commodities, the enterprise concerned should first obtain the approval document from MOFCOM before completing the customs formalities.

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

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

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

Operation enterprises must complete customs declaration formalities for the import/export goods for processing trade by presenting the Processing Trade Handbook, the Special Customs Declaration Form for Import/Export Goods for Processing Trade and other relevant documents.

(c) Bonded Supervision

- Bonded system: Under the system of processing trade administration, Customs allows 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 clients. 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. If the bonded materials and parts are under import restriction, the operation
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 Trade Handbook issued by Customs.

- **Full levy and export rebate:** Enterprises with records of violation of customs regulations or failure to complete verification and write-off 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.

- **Classified administration of enterprises:** Processing trade enterprises are classified into advanced certified enterprises, general certified enterprises, general-credit enterprises or discredited enterprises by Customs according to their respective credit status. In February 2018, the mainland authorities have revoked the customs duty deposit system based on “actual transfers” and replaced it by the provision of guarantee for customs compliance.

- **Classification of import products for processing trade:** Import and export products in processing trade are classified into prohibited, restricted and permitted categories. The catalogues of products under the prohibited and restricted categories in processing trade are released by MOFCOM and GAC from time to time. For import products classified under the prohibited category in processing trade, if they are transferred in for deep processing or transferred out by enterprises in special areas under customs supervision with bonded processing functions after going through substantial transformation, then they are not subject to administration applicable to import products under the prohibited category in processing trade.

- **Guarantee for customs compliance:** A processing trade enterprise should provide the required guarantee in the form of a security deposit or a letter of guarantee. The form of guarantee should be the same throughout a business transaction. For a letter of guarantee, the enterprise should submit the original of the letter issued by a bank or a non-banking financial institution to Customs which would then issue a receipt to the enterprise. The letter of guarantee should cover a period of 80 days upon the expiry of the Handbook. As for guarantee in the form of a security deposit, the enterprise should follow the instructions set out in the Customs Payment Notice and pay the security deposit in RMB to a custody account designated by Customs. After the deposit is credited to the account, Customs will issue a Customs Security Deposit Receipt to the enterprise. Refund of the security deposit can be processed at the finance department of Customs by presenting the serial number of the Customs Payment Notice, the refund stub of the Customs Security Deposit Receipt and the
(d) Customs Declaration

- Import-export declaration: Operation enterprises must make import-export declaration to Customs by filling out their Processing Trade 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 staff of the enterprise must be present and be 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 imported in full bond or on processed goods for reverse export.

- 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) Export Verification and Write-off

- Timeframe for Verification and Write-off

  Operation enterprises must process the imported materials and parts, and export the finished products within prescribed timeframes. They should report to the Customs for verification within 30 days upon the export of the last batch of finished products specified in the Processing Trade Handbook or the expiry of the Handbook. In case of an early termination of the contract signed with a foreign party, the operation enterprise should report to Customs for verification within 30 days upon contract termination.

- Verification and Write-off Procedures

  In completing the verification and write-off process, operation enterprises should truthfully declare to the local Customs details of the imported materials and parts, finished products for export, scraps, leftover materials and parts, defective products and by-products as well as their consumption, and submit the related documents as required. The materials to be provided for verification include: Declaration Form for the Verification and Write-off of Processing Trade Handbook; Customs Declaration Catalogue for Processing Trade Imports and Exports; Customs Declaration Form for the Destruction and Disposal of Goods in Processing Trade, receipt issued by the disposal party, proofs of the destruction and disposal as well as the related customs declaration documents for cases involving destruction of goods from the processing trade; written decision of administrative penalty, verdict and other supporting documents for smuggling cases where the processing trade rights are confiscated by
Customs or Court; as well as the supporting document specifying the remarks made by the processing trade authorities, insurance compensation notice issued by the insurance company or inspection and quarantine certificate issued by the inspection and quarantine authorities for cases where bonded goods were damaged by force majeure. For the Processing Trade Handbook cancelled and closed upon verification, Customs will issue a Notice of Cancellation and Closure to the operation enterprise concerned.

Domestic Sale of Materials, Parts and Finished Products

In the past, materials and parts imported in bond by processing trade enterprises must be re-exported after processing, and enterprises were not allowed to sell their bonded materials and parts or finished products in China. If such goods were 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 from Customs. In recent years, however, China has gradually opened up the domestic market for processing trade by facilitating the domestic sale of processing trade products, abolishing the approval requirements for domestic sale, further simplifying the taxation procedures for domestic sale and implementing consolidated taxation for domestic sale. Under the consolidated taxation system for domestic sale, qualified processing trade enterprises can first sell their bonded products from processing trade in the domestic market and complete the consolidated tax payment procedures for domestic sale with the Customs authorities by the end of the month. Enterprises engaged in domestic sale through the consolidated tax payment system have to file a record with Customs in advance by submitting the Statement on Consolidated Tax Payment Procedures for Domestic Sale and providing the required guarantee. Advanced certified enterprises and general certified enterprises are not required to provide such guarantee, whereas general-credit enterprises have to provide valid guarantee in the form of Customs security deposit or a letter of guarantee covering the specified validity period issued by the bank.

Calculation of Security Deposit

The amount of security deposit (or the amount specified in the letter of guarantee) = estimated tax for the planned domestic sales of the month x 50%, where the estimated tax = planned domestic sales of goods for the month x exchange rate at the time of application x consolidated tax rate (22%)

After the goods have been sold in the domestic market, the enterprise should promptly fill out the Goods Delivery Record under the Consolidated Taxation Procedures for Domestics Sale and complete the formalities for the Tax Levy Contact Form for Domestic Sale of Goods from Processing Trade with the customs authorities by the end of the month before the expiry of its Processing Trade Handbook. If the goods involved in the domestic sale are subject to licensing control, the enterprise should first obtain the required licence before completing the consolidated declaration for domestic sale with Customs.

Transfer of Bonded Goods for Deep Processing

If an operation enterprise wishes to transfer its processed bonded goods to another processing trade enterprise for deep processing and re-export, it must complete the necessary customs formalities before making the actual transfer. Bonded materials and
parts not processed may not be transferred.

**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 Processing Trade Handbook. With this proof, it can apply to the tax department in charge of tax levy 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 write-off procedures by submitting the export customs declaration form, the Processing Trade Handbook already verified and written-off by Customs, and the foreign exchange receipt slip. If it fails to complete the verification and write-off procedures before the time limit, the tax department in charge of export rebates, the tax levy department and Customs will jointly demand tax payment and impose penalties.

**Online Supervision of Processing Trade Enterprises**

With a view to regulating the administration of processing trade enterprises by Customs, GAC implemented the *Measures of the Customs of the PRC for the Online Supervision of Processing Trade Enterprises (Online Supervision Measures)* on 1 August 2006 based on the provisions in the *Customs Law of the PRC* and other relevant laws, administrative rules and regulations.

According to the *Online Supervision Measures*, Customs will implement online supervision over processing trade enterprises. Online supervision refers to a form of supervision by Customs over processing trade whereby processing trade enterprises are required to submit via a data exchange platform or other computer networks data on their logistics, production and operation which can satisfy the requirements of Customs supervision. Customs would then verify and check the data and conduct auditing against the material objects.

Processing trade enterprises subject to online supervision (online enterprises) should meet the following criteria: possessing the qualification to operate processing trade; registered with Customs; and being a production enterprise. The above measures do not apply to processing trade enterprises operating within special areas or bonded premises under customs supervision.

Processing trade enterprises wishing to receive online supervision may apply to the customs authorities. Upon verifying that the applicants meet the above-mentioned criteria, Customs would implement online supervision over them. Before an online enterprise submits its data to Customs via a data exchange platform or other computer networks, it should undergo identity authentication for processing trade online supervision.

Online enterprises should submit a list of import materials/parts and finished products for export in connection with their processing trade business together with the corresponding commodity codes to the customs authorities. If so required by Customs, they must also submit the relevant information to confirm the commodity codes. The customs authorities
should, based on the commodity name, commodity code and measuring units, consolidate or separate the commodities grouped by material under the internal management of the online enterprise and the commodities grouped by tariff code filed by electronic means, and establish a one-to-many or many-to-one correlation.

Upon approval granted by the customs authorities, the online enterprise may handle the tax payment procedure relating to domestic sale on a monthly basis. After the online enterprise has sold the processing trade goods on the domestic market, it should conduct the domestic sale tax payment procedure in the current month. The online enterprise should also complete the verification reporting procedure within 30 days after the verification and write-off timeframe confirmed by Customs has expired. If, due to valid reasons, verification reporting cannot be made, an extension may be granted with approval from the customs authorities; but the extension period may not exceed 60 days.

Customs may request an online enterprise to provide a deposit or a letter of guarantee from the bank as guarantee under any one of the following conditions: the administration category of the enterprise is downgraded; failure to submit truthful data to Customs; refusal to provide relevant ledger books, documents or data for Customs examination, verification and write-off; failure to complete the verification reporting procedure with Customs within the stipulated timeframe; failure to set up ledgers according to the requirements of Customs, or unsound ledger management or unclear accounts.