

# China Customs & Trade News

## Special on Pearl River Delta

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### (1) Transforming Toll Manufacturing Enterprises into Foreign Invested Enterprises

China is currently promoting the transformation of processing trade. One move is the introduction of a program which allows toll manufacturing factories to be transformed into foreign invested enterprises with minimal disruption to their daily manufacturing activities as well as other preferential treatments.

### (2) H2000 Factory Transfer Supervision System

As an effort to improve the supervision and efficiency of factory transfer transactions (i.e. transfer of bonded materials from one processing trade enterprise to another processing trade enterprise for further processing), Customs has launched a pilot programme, the H2000 Factory Transfer Supervision System, which will provide certain benefits to traders registered under the programme such as the relaxation of HS code requirements.

Look for more details in this Edition!

## Transforming Toll Manufacturing Enterprises into Foreign Invested Enterprises

### Processing Trade Environment

As a result of China's current policy on the environment, resources and low value processing trade, the Government has expanded the number of items included in the Prohibition and Restriction Lists of Commodities for Processing Trade. As goods listed on the prohibition list could only be imported under the "general trade" customs category, toll manufacturing factories may suddenly find themselves unable to import the necessary raw materials for production even if they are willing to pay customs duty and import VAT. This is because toll manufacturing factories are generally not permitted to import goods under the "general trade" category.

Those affected businesses who would like to use their existing processing trade factories to carry on production for export as well as domestic sales may consider transforming the processing trade establishments into foreign invested enterprises ("FIEs"). Under existing law, such transformation generally requires 2 steps: deregistration of the existing processing trade establishment; and the formation and registration of a new FIE. As current China regulations do not permit the coexistence of multiple factories at the same location, companies generally have to finalise the deregistration process before submitting the application for the new FIE. As the application process for the establishment of a new FIE generally takes considerable time, businesses may be forced to halt production after the deregistration of the toll manufacturing factory as they do not have valid business and import licences before the new FIE is established.

### New Measures

In view of the above, to assist and promote toll manufacturing factories in Dongguan to upgrade and transform into FIEs, the Dongguan Foreign Trade and Economic Cooperation Bureau has jointly established certain special procedures allowing, inter alia, the coexistence of two factories at the same location for a certain period of time so as to minimise business interruption during the process (see Dongwaijingmao Notice No. [2008] 40). Similar measures have also been rolled out to the Guangdong region and other regions in due course. The below are some salient points of the new measures:

- The Administration for Industry and Commerce would permit the application for a new FIE under the same name and engaging in the same principal business activities as the existing toll manufacturing factory before it is deregistered.
- A new environmental impact assessment is not required provided that there would be no change in production capacity, facilities, scale, scope, process, location, drainage level, etc. The Ministry of Environment Protection would issue the approval documents directly in such cases.
- The existing fire prevention formalities of the toll manufacturing factory could be used without re-examination and approval by relevant authorities provided that a "no change" certificate is obtained from the municipal government or the village/community committee.
- For applications of new FIEs requiring environmental and/or production safety assessments prior to establishment, the Ministry of Foreign Trade and Economic Cooperation agreed to process such applications provided that they are supported by approval documents from the relevant authorities.

- The Administration for Industry and Commerce would process the application for the Preparatory Business Licence for the FIE based on the environmental protection and fire prevention formalities previously used by the toll manufacturing factory.
- After completion of all registration formalities for the new FIE and issuance of the new enterprise registration code by Customs, Customs would not immediately cancel the registration code of the toll manufacturing factory and would retain the code for 3 months (with a possible extension of another 3 months). Within this period, the verification and cancellation of the toll manufacturing contract/agreement and the deregistration of the processing trade enterprise could be performed.
- Customs would assign the same customs grading and provide the same preferential customs clearance treatment (where applicable) to the new FIE as the previous toll manufacturing factory.
- The new FIE would not be required to provide any customs deposit or letter of guarantee for obtaining its first customs handbook. Factory audits typically performed by Customs for new company registration and first customs handbook issuance would not be required also.
- If the processing trade enterprise is being investigated or audited by Customs, Customs would still permit the transformation of the processing trade enterprise into an FIE provided that a written statement stating that the new FIE would assume all legal responsibilities, rights and obligations (including any fines or penalties from Customs) of the processing trade enterprise is in place.
- Applications for the transformation could be made at the one-stop service centre and companies are not required to submit individual applications separately to the relevant authorities, such as the Ministry of Environment Protection and the Administration for Production Safety Supervision, for new FIE applications.

- The remaining balance of raw materials in the customs handbook and the consigned equipment (commonly known as non-priced equipment) imported by the toll manufacturing factory with customs duty and import VAT suspended can be transferred to the new FIE without being subject to customs duty and import VAT provided that certain conditions are met.

In view of the uncertainty surrounding processing trade, it is advisable for companies to consider taking advantage of the new measures and transform their processing trade enterprises into FIEs. This should also provide businesses with more flexibility in terms of production and distribution including domestic sales.

## H2000 Factory Transfer Supervision System

Factory transfer represents the transfer of bonded materials from one processing trade enterprise to another processing trade enterprise for further processing. The procedures for factory transfers are currently governed by General Administration of Customs (“GAC”) Decree No. 109. With an aim to improve the management and efficiency of factory transfers, the GAC has recently introduced a set of trial measures promoting the use of the H2000 factory transfer supervision system. Huangpu Customs has rolled out these trial measures to those companies registered for the pilot programme with effective dates as follows:

For factory transfers between enterprises locating within Huangpu Customs’ territory	1 September 2008
For factory transfers involving enterprises outside of Huangpu Customs’ territory	1 October 2008

The below are the key benefits and procedural differences of the H2000 factory transfer supervision system as compared to the measures under GAC Decree No. 109:

- Applications, registrations and approvals for factory transfers under the H2000 system are performed electronically.
- Under GAC Decree No. 109, both the transfer-in and transfer-out company are generally required to apply the same HS codes up to the 10-digit level for the factory transfers. Under the trial measures, only the first 4 digits are required to be the same.
- The trial measures also provide an opportunity for companies to amend the factory transfer application form under certain circumstances. Amendment to the application form is generally not permissible in practice under GAC Decree No. 109.
- Under the trial measures, companies are generally required to submit electronic delivery registration forms within 24 hours of delivery except those under online customs supervision where a 72-hour deadline applies. An extension of up to 7 days may be possible. There is no such timeline requirement specified in GAC Decree No. 109.
- Under the trial measures, the transfer-in company must complete customs declaration within 40 days of receipt of the goods. The transfer-out company must complete customs declaration within 10 days of the date the goods are declared by the transfer-in company. Under GAC Decree No. 109, customs declaration must be completed within 90 days of delivery.

The trial measures should allow factory transfers to be conducted more efficiently. Furthermore, with the relaxation of certain requirements, companies that did not satisfy the requirements under GAC Decree No. 109 may now conduct factory transfers under the trial measures. For example, companies currently conducting Hong Kong round-trip businesses may consider adopting the factory transfer model which may be more cost and time efficient.

Notwithstanding the above, please note that companies are still required to obtain Customs approval prior to delivery. In addition, companies should pay close attention to the various timing requirements under the trial measures.

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