

Managing customs and international trade



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Would your inter-company transfer prices pass a customs valuation audit and how should you deal with retrospective price adjustments?

Does your Customs Handbook balance? If not, what are the solutions?

What bonded zones are used in your supply-chain to reduce VAT leakage, lead times and enable bonded transfers?

What standard operating procedures have you implemented for managing and resolving customs audits and investigations?

How would you manage a Customs audit to minimise the adverse impact on your business?

Have you upgraded Enterprise Classification in order to reduce clearance times, audit frequency and other related supply-chain costs?

The Approach

At PricewaterhouseCoopers we believe that managing customs and international trade in China is best organised as follows:



Creating Value

Now more than ever before, companies can proactively take steps to reduce customs duty and related supply-chain costs and improve operating performance. For example, companies using paper Customs Handbooks can upgrade to electronic Customs Handbooks. The new bonded zones can be used to reduce VAT leakage, lead times, and enable more efficient bonded transfers. Enterprise Classification can be upgraded in order to reduce clearance times and audit frequency. China's growing network of Free Trade Agreements can be used to legitimately reduce the customs duties that are assessed on imported and exported goods.

Ensuring Compliance

The regulatory environment in China is complex and continually evolving. The decentralised structure of the Customs authority leaves scope for local interpretation, which results in a gap between the national regulations and the local practices. For example, standard operating practice in Processing Trade is different in Southern China compared to the rest of the country. Meanwhile, business models often evolve at a much faster pace than the rules. Companies can conduct self-assessments, implement best-in-class procedures, and adopt other strategies in order to ensure compliance and therefore avoid unwanted surprises.

Managing Risk

China Customs is a revenue-driven authority. In order to meet the revenue target set by the central government, Customs is employing a variety of supervision means to ensure customs duty and import VAT collection, including post-importation audits and criminal investigations. The closest scrutiny is given to such areas as customs valuation of related party transactions and the handbook operation of companies engaged in Processing Trade. Consequently, customs duty, consumption tax, and import VAT can become an even more significant cost in the supply-chain. Almost all companies are invariably selected for audit by the authorities at some point in time. Robust defence procedures and documentation should be in place in order to resolve an audit or investigation with minimal financial and reputation exposure, and a guarantee of business continuity.

Benchmarking

Business evolution and growth

Many multi-national companies have grown rapidly, often through acquisition or joint ventures, yet have failed to capitalise on pooling their increased customs resources or sharing of customs knowledge and systems/processes. Organisations with a strong business unit level culture of independence often suffer similarly. Multinationals who have entered into joint ventures or have acquired local Chinese businesses often inherit flawed customs practices or under-resourced customs functions and either do not have the knowhow to put things right or encounter significant resistance to change.

The impact of Customs

Core customs competencies, such as product valuation, origin and tariff classification, impacts business at both strategic and operational levels. For example, the government implements certain economic and environmental policies by use of HS Codes, such as the Prohibition List for Processing Trade, and export VAT refund rates. So, incorrect tariff classification can have a significant negative impact where for example it determines whether or not a business can engage in bonded manufacturing and what amount of export VAT refund it can claim.

Best practice

You would think therefore that given these diverse and significant risks and potential lost opportunities that companies would have developed adequate resources and centres of excellence to manage the customs function but this is far from reality. There are many reasons for this and some are specific to China and its environment.

Although it is not always widely known, those current “customs best-in-class” companies typically started from a low baseline. In many cases, they have been subject to Customs investigation (including employee detention). Significant financial, operational and reputation exposure resulted. As a consequence, new resources were allocated to manage customs and trade in China.

Our Services

Our specialist customs and international trade practice provides a wide range of tailored solutions, including:

Creating value

- Upgrading the Enterprise Classification
- Upgrading the Customs Handbook
- Reducing the VAT leakage on exports
- Optimising use of bonded zones
- Using Free Trade Agreements
- Customs supply-chain business modelling
- Optimising duty-fee quota for imported capital equipment

Ensuring compliance

- Establishing and implementing KPI/KOI for customs and trade compliance
- Conducting compliance assessments
- Conducting training
- Obtaining pre-classification decisions on tariff classification and goods valuation
- Completion of foreign exchange verification and cancellation for trade payables/receivables with the State Administration for Foreign Exchange (SAFE)
- Completing commodity inspection, import licensing and related matters with the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) and the Ministry of Commerce (MOFCOM)
- Managing customs brokers

Managing risk

- Defense documentation
- Best-in-class operating procedures
- Tactical and technical support during audits and investigations

Our experience

A foreign invested enterprise importing consumer products

An employee of the client left involuntarily and as a consequence reported alleged under valuation of imported goods to the Anti-smuggling bureau (ASB). The ASB initiated an investigation that entailed the temporary detention of employees, seizure of documentation and extensive interviews. Incoming shipments were held at the port and significant cash deposits collected.

How we helped

We firstly assisted the client to release the employees from temporary detention and to release incoming shipments. We then independently reviewed the technical customs valuation issues and alleged offence. As a result, robust defense documentation, which linked transfer pricing and customs valuation, was prepared and submitted to the ASB that supported the past import declarations. Tactical advice was provided to the client in respect of how best to resolve the case.

Benefit for the client

There was no criminal prosecution of the company or employees. The claw-back of customs duties and financial penalty was reduced. The company's reputation suffered no long-term damage and business continuity was ensured.

A foreign invested enterprise engaged in bonded manufacturing

The client's customs handbook did not balance and duty-free capital equipment was missing. The Customs authority therefore assessed a claw-back of customs duties and imposed financial penalties. The Enterprise Classification was downgraded from "A" to "B" and the external auditor required the financial statements to be qualified due to potential unquantified financial exposures.

How we helped

We conducted an independent compliance review that identified the root causes for the customs handbook imbalance and recommended solutions. We developed a compliance improvement plan, including transition to e-handbook, and new standard operating procedures. Cost saving improvements for bonded transfers and outsourced processing were also identified. Several months later we completed follow-up compliance testing to ensure that the recommendations were implemented and that customs compliance levels were satisfactory. We also reviewed the supply-chain for relevant Free Trade Agreements, and changed procedures to take advantage of lower duties in destination markets for future exports.

Benefit for the client

No further assessments for claw-back of customs duties and financial penalty were made by the Customs authority. The auditor no longer required qualification of the financial statements and the Enterprise Classification was reinstated.

Our experience

A foreign company engaged in low-cost sourcing for North America

The cost of sourcing from China was becoming evermore expensive due to inflation and labor cost increases, appreciation of the RMB, and reductions in the export VAT refund rates. The client requested us to review the procurement supply-chain to identify cost saving opportunities and areas for improvement.

How we helped

We independently reviewed the sourcing model, VAT refund procedures, surveyed and interviewed selected vendors, reviewed the existing HS Codes, reviewed the INCOTERMS and export procedures. We also undertook high-level financial modeling that quantified the cost savings.

Benefit for the client

Products were re-classified under a new HS Code, per a pre-classification decision obtained from Customs, which resulted in the VAT refund rate increasing from 5% to 13%. A new procurement structure was identified that resulted in a reduction of VAT leakage equivalent to 1.5% of the value of the goods being sourced.

A foreign invested enterprise establishing a distribution center

The client's manufacturing base and consumer market was becoming increasingly China and North East Asia focused. Establishing a distribution center in traditional locations like Singapore and Hong Kong would not have met the demands of the future business in terms of operating cost and lead times.

How we helped

We worked with the client to identify the correct bonded zone location, legal structure and operating model, so as to address the respective customs, supply-chain, foreign exchange, operational, tax, and transfer pricing issues. The distribution centre included non-bonded and bonded storage in a single-roof location, VAT refunds were secured, origin under Free Trade Agreements was preserved and a tax Permanent Establishment in China avoided.

Benefit for the client

A preferred Asia bonded distribution centre in China was established. The competing and sometimes conflicting tax, customs, legal and supply-chain requirements were successfully optimized.

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For more information, please also visit: www.pwccustoms.com

PricewaterhouseCoopers' Customs & International Trade Practice

Customs and international trade in China is complex. However, a planned and structured approach with the right resources assigned results in cost savings, higher levels of compliance and fewer unwanted surprises during an audit. PricewaterhouseCoopers' specialists within our Greater China customs and international trade practice provide a wide range of advice and services related to creating value, ensuring compliance, and managing risk in relation to the movement of goods into and out of China.

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