

How will processing trade in the Pearl River Delta cope with new challenges?

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In our October 2008 edition of the China Customs and Trade News, we reported on the series of reform policies released in relation to processing trade in the Pearl River Delta. The Pearl River Delta, China's leading processing trade region has undergone rapid transformation and has been pressurised by this industry reform throughout recent years.

Processing trade (including contract manufacturing and toll manufacturing), has contributed greatly to China's development for it being renowned as the "world's factory floor" for over two decades. However, with continued globalisation and the reduction of China's customs duties, the risks associated with processing trade is beginning to equalise its returns, if not overtaking it. The series of reform policies released by the Chinese Government and the active implementation and enforcements by local authorities since 2008, and in particular, the gradual closing down of toll manufacturing and the offering of the distinctive "same location Wholly Foreign Owned Enterprise (WFOE) conversion" regime to import processing manufacturers, have all led to the slowing down of processing trade. Is this an era to an end, or what new is to be expected of processing trade?

Processing trade in the Pearl River Delta – recent changes

On 14 November 2011, the Ministry of Finance (MOF), the Ministry of Commerce of the People's Republic of China (MOFCOM), the General Administration of Customs (GAC) and the State Administration of Taxation (SAT) announced the <Joint Notice on Tax Preferential Policy on Imported Equipment Transfer for Toll Manufacturing (TM) Factory Converting to foreign-invested enterprise (FIE)> Caiguanshui [2011] No.66, stated that the tax preferential treatment for the "same location WFOE conversion" is extended to 31 December 2012.

Under the new policy, transfer of non-priced equipment will be exempted from import duty and value added tax (VAT) claw-back and the remaining customs supervision period for the non-priced equipment will be carried forward for (i) the TM factory's non-priced equipment converting into capital injection for setting up new FIE from 1 July 2011 to 31 December 2012; or (ii) the TM factory's non-priced equipment converting into capital injection of the existing FIE under a

same investor from 1 July 2009 to 31 December 2012. Having said that, all of the following criteria have to be satisfied to claim for such exemption:

- the Processing Trade registration for the non-priced equipment were completed on or before 31 December 2008
- the non-priced equipment were imported on or before 30 June 2009
- the non-priced equipment are still under customs supervision.

For those non-priced equipment which were transferred to a new FIE as non-priced equipment from 9 September 2008 to 30 June 2009, it could be further transferred to be capital injection for the same FIE with Customs duty/Import VAT exempted, Customs supervision period being carried forward as well.



Highlights of the new processing trade regime

- The Pearl River Delta continues to lead and will act as the next demonstration zone of the “same location WFOE conversion” regime, with an aim to complete conversion in a period of three years. The implementation period of the preferential policy for non-priced equipment being transferred into invested equipment under duty free status is extended to 31 December 2012.
- Enterprises permitted to “same location WFOE conversion” may share the same practice of relocating enterprises in which non-priced equipment can be transferred to the FIE under the same investor and benefit from preferential policies such as the duty-free transfer of surplus materials, etc.
- Facilitation of better and more convenient applications for the domestic sale of bonded goods and bonded equipment. Requirements for goods to be 100% exported, and goods produced from non-priced equipment to be 70% exported may also be eased or even cancelled in the near future.
- E-network supervision will be implemented for processing trade enterprises in the Henqing New Area and Dongguan city, establishing a “virtually enclosed management zone”, enhancing operational flexibility.
- Current problems in processing trade unit consumption management are likely to be resolved with the introduction of a new bonded manufacturing unit consumption management regime known as the “unit consumption generation system”.
- Enhance and promote the importance of enterprise self-compliance and to widen the treatment gap between high grading and low grading enterprises.
- Enhance the support of deep processing bonded transfer and to increase the inner areas processing trade growth rate particularly in the western regions.

Final comments

The urge of same location WFOE conversion

“Same location WFOE conversion” and upgrading of processing trade enterprises are given priority to be promoted by local governments. Thus, relevant preferential policies continue to remain in force and applicable to a wide range of areas. For those enterprises with practical needs to be converted, we recommend this great opportunity to be seized.

Customs and trade compliance is essential to operation

Compliance of import and export activities is subject to strict supervision and control by China Customs and other relevant authorities. Customs has placed higher value on enterprises’ compliance management through the enterprise grading program. An enterprise that has experienced “same location WFOE conversion” would earn itself an optimal

time-match with the new momentum to re-establish an internal compliance management system for customs-related activities.

Thorough upgrading on management system is of top priority

Enterprise management and supervision systems are becoming more intelligent and convenient. Online supervision will be fully implemented in the field of processing trade. Together with the non-stop upgrading of local supervision systems, conventional management modes of processing trade within the Pearl River Delta are in imperative needs of conversion. Accordingly, the rapid development of external intelligence system poses an increasing need to further enhance inner management procedures and system for enterprises. Therefore, how to set up an effective internal management system and corresponding regulations will be a matter of great significance to a majority of enterprises.

Multi-functioning of bonded zones

New bonded supervision zones with more complete functions are under construction, within which various functions such as aggregate production, processing, logistics, inspection, maintenance and so on are currently tested and being developed. Renewed emphasis on the innovative concept of bonded repairing centres is put after going through repeated testing and experiments. This will effectively bring more business opportunities to foreign companies with the intention to establish repairing centres in China.

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