

## **PRC Legal Rules on Bonded Goods on Export Processing**

Bonded goods are defined under the PRC Customs Law as the goods, entering the PRC territories with customs approval to defer the payment of duty and VAT, which are to be reshipped out of the PRC territories after being stored, processed and assembled. <sup>1</sup> The Chinese law provides two categories of bonded goods: bonded goods kept for consumption later; bonded goods for use in export processing or assembling.

### Properties for bonded goods

Bonded goods possess the following properties:

(1) Since they are not treated as imports, bonded goods in general are not subject to the requirement for import licenses, with the exception for the importation of following products: ozone-depleting substances (ODS), chemicals used for making drugs, and controlled chemicals.

(2) One can add value to the bonded goods by performing processing and assembling work on them, or one can just keep them in storage in original shape and condition for later use and consumption. If the bonded goods in storage are later sold for consumption in the PRC, the Chinese customs shall collect import duty and VAT on the goods. Accordingly, the status of the bonded goods changes from bonded goods into general goods, and the rules for import license shall apply. If the bonded goods are later sold for consumption outside China, there will be no duty and tax consequences. One example of this tax exemption will be the fuel and consumable supplies imported for use by aircraft and ocean going vessels in international transportation. Bonded goods not for use in export processing can be kept at special economic areas like free trade zone, export processing zone or bonded logistic parks, where no import duty and VAT are collected upon importation. Bonded goods can be used in the manufacture of export goods under an export processing agreement. When this happens, the goods under export processing is subject to the special customs rules governing the recording, storage, use and movement for those goods. Bonded goods for direct consumption can be used as a security for legal charges, pledged or be the subject of a lien, but the bonded goods used for export processing is not permitted to have such financing arrangements.

(3) The Chinese customs shall not collect duty and VAT on the bonded goods imported under export processing contracts on condition that they are reshipped out of China after the completion of the processing activities within one year. The Chinese customs shall collect duty and VAT if the bonded goods used in export processing stay inside the PRC after the allowed one-year period is over. In addition, the requirement for import license

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<sup>1</sup> See Article 100 of the PRC Customs Law.

shall apply. Note that bonded goods if kept in free trade zones and export processing zones, can stay without such one-year time limits.

(4) Since the export processing enterprise (the EPE) can take delivery of the imported goods without the requirement for the payment of duty and taxes, the Chinese law provides that the EPE needs to provide security for the importation of the bonded goods. In practice, the bonding system has two variants depending on the categories of the bonded goods used in export processing, as classified by the Ministry of Commerce, and the classification of the EPE by the customs in charge, as announced by the General Administration of Customs.

(5) The bonded goods, whether they are kept for later consumption or used in export processing, are under customs supervision throughout the allowed period of stay inside the PRC, commencing from the date of customs release to the date of lifting customs supervision. The taxpayer can apply for the lifting of customs supervision over the bonded goods after the goods have been re-shipped out of China or payment of import duty and VAT plus interest if applicable, to turn the bonded goods into general import-export goods. Note that accrued interests are payable where the goods have been imported for export processing previously. Bonded goods for direct consumption in China do not accrue interests when they are shipped from special economic areas to the rest of China.

(6) There is a legal requirement for customs verification preceding the lifting of customs supervision over the bonded goods, in order that the EPE can discharge the legal liability for the importation of the bonded goods under the production contract. The EPE can redeem the security deposit afterwards.

#### Security accounts and deposits

The following is a summary on customs rules for setting up security account and the payment of deposit for different types of export processing enterprises (the EPE) that process goods under different categories. The security bonding system may not apply to some EPE for transactions relating to the importation of sub-materials with value not exceeding USD10,000. If it does apply, the EPE may be required: (i) to set up security account only without the requirement for deposit, (ii) to set up security account and put up 50% deposit on the amount of duty and VAT for the imported materials, or (iii) set up security account and put up 100% deposit on the amount of the duty and VAT for the imported materials. The customs also accept bank guarantee in lieu of security deposits. Note that the security bonding system shall not apply to the enterprises that are created in the special economic areas: free trade zones, export processing zones and bonded logistic parks, and the EPE situated outside the above-mentioned special economic areas that is supervised under the customs computerized networking system.

Policy document No. 44 on export processing

The Ministry of Commerce (the MOC) issued a policy document (No. 44) on 23rd July 2007 setting out details of policy change. Before 23<sup>rd</sup> August 2007, the EPE is required to set up security accounts and place deposits at the bank as below:

		Prohibited Category	Restricted Category	Permitted Category	Sub-materials not exceeding USD10,000
1	Type AA enterprise	Not permitted	Not required to set up account	Not required to set up account	Not required to set up account
2	Type A enterprise	Not permitted	Set up account but no deposit required	Set up account but no deposit required	Not required to set up account
3	Type B enterprise	Not permitted	Set up account and 50% deposit	Set up account but no deposit required	Not required to set up account
4	Type C enterprise	Not permitted	Set up account and 100% deposit	Set up account and 100% deposit	Set up account and 100% deposit
5	Type D enterprise	Not permitted	Not permitted	Not permitted	Not permitted

After 23<sup>rd</sup> August 2007, the scope for setting up security accounts and placing deposit has been expanded to include type-AA EPE and type-A EPE for processing goods under the restricted categories. The requirement for security account and deposit under the new policy is set out below:

		Prohibited Category	Restricted Category	Permitted Category	Sub-materials not exceeding USD10,000
1	Type AA enterprise	Not permitted	<u>Set up account and 50% deposit</u>	Not required to set up account	Not required to set up account
2	Type A	Not permitted	<u>Set up</u>	Set up	Not required to

	enterprise		<u>account and 50% deposit</u>	account but no deposit required	set up account
3	Type B enterprise	Not permitted	Set up account and 50% deposit	Set up account but no deposit required	Not required to set up account
4	Type C enterprise	Not permitted	Set up account and 100% deposit	Set up account and 100% deposit	100% deposit on duty and VAT amount
5	Type D enterprise	Not permitted	Not permitted	Not permitted	Not permitted

It is observed that the scope of the security bonding system has been, for the first time, expanded to cover certain export goods falling under the restricted category. Before the date of new policy, only imported materials under restricted category to be used for export processing were included in the security bonding system.

#### Exceptions to document No. 44

Policy document No. 44 provides for three exceptions:

(1) The policy document No. 44 shall apply to EPE situated in China's Eastern Region including Beijing, Tianjin, Shanghai, Liaoning province, Hebei province, Shandong province, Jiangsu province, Zhejiang province, Fujian and Guangdong provinces. Note that provinces and cities not mentioned above are categorized as the Central and Western region, to which the policy document No. 44 does not apply.

(2) Where the export process requires the transfer of the bonded goods from one EPE to another for substantive processing, the requirement for security account and deposit is not required for type-AA EPE and type-A EPE. The Chinese government has pursued a policy of encouraging substantive processing that could add more value to the goods in export processing.

(3) Where the EPE is situated in special economic areas like free trade zones, export processing zones, and bonded logistic parks, the policy document No. 44 shall not apply either.

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