

Duty and VAT rules in PRC designated economic areas

Designated economic areas include free trade zones, export processing zones, and bonded logistic parks. The establishment of free trade zones (the FTZ) requires the approval from the State Council.¹ The free trade zones (FTZs) are excluded from the Chinese customs zones under the Chinese laws. Goods traded among enterprises situated inside the FTZs are not subject to duty and VAT. Goods shipped between the FTZ and destinations in other countries or regions are exempted from import duty and VAT. Production equipment imported for use by the enterprises in designated free trade zones is exempted from duty and VAT. Goods other than self-used production equipment imported from a destination in other country to the free trade zone are bonded goods.² The duty and VAT treatment for bonded goods will vary depending on the way they will be used and where the final destinations will be:

	Use and final destinations	Duty and VAT obligations
(i)	Bonded goods sold between enterprises within the FTZ	Exempted from duty and VAT
(ii)	Bonded goods used exclusively in the manufacture of export products by enterprises within the FTZ	Exempted from duty and VAT, if the bonded goods after processing are shipped out of China within one year. ³
(iii)	Bonded goods delivered to enterprise outside the FTZ for exclusive use in the manufacture of export products	Exempted from duty and VAT, if the bonded goods after processing are shipped out of China within one year. Security for duty and VAT shall be provided under security account system.
(iv)	Bonded materials, parts and components sold by an enterprise situated inside the FTZ to an enterprise situated outside the FTZ (elsewhere in the PRC)	It is considered to be import and subject to duty and VAT.
(v)	Finished goods, consisting of imported components, are sold by an enterprise situated inside the FTZ to an enterprise situated outside the FTZ (elsewhere in the PRC).	It is subject to duty and VAT. If the finished goods consist of both imported and locally purchased components, the customs shall levy duty and VAT on the amount of imported components only. ⁴
(vi)	Bonded goods sold or returned to	Exempted from duty and VAT

¹ See Article 57 of the PRC Customs Law.

² See Article 12 of the Customs Policies on Free Trade Zones, issued by the General Administration of Customs on 1st August 1997.

³ See Order No. 314 (1999) issued by the Ministry of Foreign Trade and Economic Cooperation on 27th May 1999.

⁴ See Article 22 of the Customs Policies on Free Trade Zones, issued by the General Administration of Customs on 1st August 1997.

	destinations in other country or regions	
(vii)	Bonded goods stay within the PRC for a period exceeding 1 year.	Bonded goods can stay in FTZ and EPZ without time limit.

Goods delivered by an enterprise situated in the non-FTZ areas (elsewhere in the PRC) to an enterprise situated inside the FTZ are considered exports and these goods are eligible for VAT export rebates after the goods physically leave the FTZ for overseas destinations.

The establishment of the export processing zone (the EPZ) requires the approval from the PRC state council, and the EPZ must be located within the existing Economic and Technology Development Zones.⁵ It is useful to compare the differences between the free trade zones (the FTZ) and the export processing zone (the EPZ). First, one can carry on trading, re-export, and exhibition business in the FTZ, but one cannot do the same business in the EPZ. Second, one can only carry on simple export processing activities in the FTZ, but one can carry on substantial export processing activities in the EPZ. Third, The same exemption of duty and VAT treatment applies to the goods shipped between export processing zones and the destinations in other countries (or regions). However, the duty and VAT treatments for the movement of the goods between the zone and elsewhere in the PRC are different. Shipment of goods from an enterprise situated inside the EPZ to an enterprise situated outside the EPZ (elsewhere in the PRC) is treated as imports. Goods imported from the EPZ shall be subject to import duty and VAT on the full value of the finished goods, with no distinction between imported and domestically purchased materials. Such tax treatment is different from the importation of goods from enterprises situated in the FTZ into the non-FTZ (elsewhere in the PRC) that we have just mentioned above. Shipment of goods from an enterprise elsewhere in the PRC to enterprise situated inside EPZ is treated as exports. However, the VAT export refund treatment is different from that in free trade zones: (i) materials and semi-finished goods delivered by an enterprise situated in the non-EPZ (elsewhere in the PRC) to an enterprise situated in the EPZ are eligible for VAT export rebates immediately, without the requirement for those goods to physically leave the Chinese territories; (ii) domestically manufactured production equipment sold by enterprises elsewhere in the PRC to the EPZ enterprise is also eligible for immediate export refunds. But imported equipment sold by non-EPZ enterprise to the EPZ enterprise does not receive the export refund treatment.⁶

Note that by “the enterprise situated in the non-EPZ” (or the FTZ), it is meant the Non-EPZ enterprise must be a general VAT taxpayer who has been duly registered as the foreign traders in accordance with the PRC foreign trade law. Sellers situated elsewhere in the PRC and who have not completed the registration procedures as foreign traders are not eligible for export refund treatments.⁷ Goods shipped into and

⁵ See Article 2 of the Tentative Administrative Measure by the PRC Customs for the Supervision over the Export Processing Zone, issued by the General Administration of Customs on 24th May 2000.

⁶ See Article 27 of the Tentative Administrative Measure by the PRC Customs for the Supervision over the Export Processing Zone, issued by the General Administration of Customs on 24th May 2000.

⁷ See Article 2 of document Guo Shui Fa 155 (2000) by the State Administration of Taxation.

out of bonded logistic parks (the BLP) receive same duty and VAT treatment as that for the EPZ. Both the FIE situated in the FTZ and BLP can carry on trading activities.

Effect from July 2005, the Chinese government has granted the wholesale distribution right to the FIE situated in the BLP.⁸ The FIE situated in the FTZ only has the import-export rights and has no distribution rights. It is useful to compare the different scope of business activities that the FIE can perform in the designated economic areas as below:

	Designated Economic Areas (duty and VAT free)			Non-designated Economic Areas
	Free trade zone	Export processing zone	Bonded logistic park	Elsewhere in the PRC
Trading	Yes	No	Yes (a)	Yes (b)
Exhibition	Yes	No	Yes	Yes
Re-export	Yes	No	Yes	Yes
Export processing	Yes (c)	Yes (d)	Yes (e)	Yes (f)
Storage	Yes	Yes	Yes	Yes
Transportation	Yes	Yes	Yes	Yes

- (a) Under Order No. 76 of the General Administration of Customs effective from 13th July 2005, the foreign invested commercial enterprise (the FICE) located in the BLP can apply for the wholesale distribution right, in addition to the import-export rights.
- (b) Under Order No. (2004) 8 of the Ministry of Commerce effective from 11th December 2004, the foreign invested commercial enterprise created elsewhere in the PRC can apply for both the wholesale and retail distribution rights, in addition to the import-export rights.
- (c) The FIE can only carry on simple export processing activities.
- (d) The FIE can carry on extensive processing activities and the sellers of the goods to the EPZ enterprises are eligible for immediate export refunds.
- (e) The FIE can carry on simple export processing, packing, bulk-breaking, regarding, sorting and labeling activities.
- (f) The export processing enterprise must provide the Chinese customs with a bond for the importation of bonded materials, and use the customs manual to import the bonded materials, parts and components.

⁸ See document Shang Zi Zi 76 (2005) jointly issued by the Ministry of Commerce and the General Administration of Customs on 13th July 2005.