

China Tax Alert

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China Customs released Provisional Measures on Credit Management of Enterprises

Regulations discussed in this issue:

- Recently, the General Administration of Customs announced the *Provisional Measures of the PRC on Credit Management of Enterprises* on 8 October 2014, and it will come into operation on 1 December 2014. *Customs Certification Criteria on Enterprises* will also be announced and put into effect at the end of this year.

Background

The China General Administration of Customs (GAC) will soon replace the present enterprise management system with a more simplified system of classification to bring it in line with internationally accepted best practices. These expected changes will directly affect the selection criteria, range of benefits, and enterprise ratings currently enjoyed by companies. Since this would impact all companies transacting with Customs, it is very important for management to fully understand and cautiously consider these expected changes in light of the immediate implications these could have on their existing qualification, the efficiency of their Customs clearance process, and their chances of being subject to customs audits in the future. Companies seeking to upgrade their current enterprise rating in order to avail of Authorised Economic Operator (AEO) benefits would be especially encouraged to revisit the viability of their present situation in consideration of these anticipated changes.

The GAC has been constantly refining the enterprise management system since the first rules were released more than 25 years ago. For the purpose of enacting this latest round of revisions, the GAC has announced the *Provisional Measures of the PRC on Credit Management of Enterprises* (hereinafter referred to as "Provisional Measures"). The GAC also recently circulated a draft of the *Customs Certification Criteria on Enterprises* (hereinafter referred to as "Certification Criteria") which will be finalized and put into effect by the end 2014.

For the benefit of companies interested in learning about the possible changes and implications that this new regulation may have on their operations, we are issuing this China Tax Alert to summarize key revisions and the possible overall impact it may have on the relationship between the Customs and companies.

Key points

The main reason for revising the Provisional Measures is to keep the enterprise management system in line with international standards, particularly with regard to: a) the use of an AEO system that will provide differential customs treatment for enterprises with various credit levels, and b) alignment with the

upcoming Certification Criteria that conforms with World Trade Organization (WTO) standards. Based on our intelligence, the Certification Criteria is being edited for the final round. As compared with the current Administrative Measures, the Provisional Measures differ in the following ways:

I. Changes in classification measures for enterprises

China Customs is now more geared towards enhancing its AEO system. Companies in China that are certified (i.e., advanced certified enterprises and generally certified enterprises) as AEO will be able to enjoy preferential customs clearance benefits in China and in countries which China has mutual recognition agreements with (e.g., Korea, Singapore). However, instead of a one-time classification, enterprises of a high credit standing will be re-evaluated from time to time, to better manage potential customs risks. Furthermore, the Customs will apply a credit rating system within the Validation Audit procedure to clarify administrative standards. These changes are summarized below:

- Simplified classification of enterprises. The current system that divides enterprises into five categories (AA, A, B, C and D) will be replaced by a simplified system with four category levels:
 - Advanced Certified Enterprises (ACE)
 - Generally Certified Enterprises (GCE)
 - Regular Credit Enterprises (RCE)
 - Discredited Enterprises (DE)

ACE and GCE (also known as Certified Enterprises or CE) will be considered as AEOs in China. In addition to management measures applied to GCEs, ACEs can enjoy special customs clearance privileges in China and in countries which have mutual recognition agreements with China. Whereas, whether GCEs can enjoy the special customs clearance privileges would depend on the AEO negotiation results between the China Customs and the counterparties of other countries.

- Establishment of a dynamic adjustment system. Article 15 of the Provisional Measures states that *“Customs should review the qualifications of Advanced Certified Enterprises every three years and perform a reassessment on Generally Certified Enterprises on a random basis. Generally Certified Enterprises who fail the reassessment, will lose their General Certification and will not be allowed to apply for certification within one year. Advanced Certified Enterprises who fail the advanced assessment but pass the general assessment would be subject to the management of Generally Certified Enterprises”*.
- Allow the involvement of agencies in customs administrative procedures. The Provisional Measures state that *“Customs or enterprises can entrust qualified agencies to perform the customs assessment. The results can be taken as references for the credit assessment once recognised by Customs”*.
- Clarify the credit rating treatment for enterprises in the case of registration information changes, merger and acquisition (“M&A”). Under the circumstances where enterprises change their company name or the Customs registration numbers, the previous customs assessments of enterprises’ credit status and management measures should remain unchanged. On the other hand, as for the newly established enterprises as a result of the M&A, they should be regarded as the first-time-registered enterprises for the credit rating assessment purposes.

II. Clarify treatments of customs clearance for enterprises of different classification

The Provisional Measures grants CEs preferential treatment during the Customs clearance and clarifies the supervision measures for discredited enterprises.

- Preferential treatment to granted for GCE include:
 - i. A relatively low inspection rate on import/export goods
 - ii. Simplified document review of import/export goods
 - iii. Prioritised clearance treatment of import/export goods
 - iv. Other administrative principles and treatments announced by the GAC
- On top of the preferential treatment applied to GCEs, ACEs shall enjoy the following administrative measures:
 - i. Advanced release of import/export goods before the completion of customs clearance procedures, such as goods classification, valuation, country of origin, etc.
 - ii. Assignment of a dedicated liaison officer for the enterprises
 - iii. Bank deposit account system would not be required for enterprises engaged in processing trade
 - iv. Preferential clearance benefits in countries that have signed AEO Mutual Recognition Arrangements with China
- Management principles and measures for regular credit enterprises will include:
 - i. An average inspection rate on its import/export of goods
 - ii. General document review of its import/export operations
 - iii. A sequential, chronological clearance procedure for the import/export of goods
 - iv. Other administrative principles and treatments announced by the GAC
- Finally, the management principles and measures for discredited enterprises will be as follows:
 - i. A relatively high inspection rate on its import/export of goods
 - ii. Intensive document review of its import/export operations
 - iii. Key supervision on processing trade and other businesses
 - iv. Other administrative principles and treatments announced by the GAC

III. An innovation in customs management measures

The Provisional Measures introduces a system of managing the credit / reputation of companies based on their levels of customs management. For the first time, the Customs will publicize the credit rankings of companies, which indicates that China Customs is becoming more transparent. This also encourages companies to improve their compliance and to strive for smoother clearance options by maintaining their image and reputation.

- The Article 6 of the Provisional Measures states that the Customs shall collect the following information which would reflect the credit levels of enterprises that would help in establishing how the credit management system applies to them:
 - i. Registrations information with the Customs
 - ii. Information on import/export operation
 - iii. AEO mutual recognition information
 - iv. Information in other administrative departments
 - v. Other information related to trading business
- The Article 7 of the Provisional Measures reads that the Customs shall, under the condition of that state secrets, confidential business information and personal privacy are protected, publish the following credit information of enterprises:

- i. Registration information with the Customs
- ii. Customs assessment of the enterprises' credit status
- iii. Administrative penalty information
- iv. Other information that shall be published

KPMG's observations

The Provisional Measures is a breakthrough in the ongoing development of China Customs' enterprise classification system, and is expected to be of significant benefit for both the Customs and the business community. In preparation for these changes, enterprises will have to pay close attention to the followings:

- As far as we understand, during the transition, enterprises can still apply for advanced certified level before the new validation criteria comes into effect on 1 December 2014. Depending on the local Customs administrations, enterprises with AA or A ratings will be directly reclassified as ACE or GCE.
- The Provisional Measures operate within a dynamic adjustment system. The Customs will perform re-assessments on the advanced certified enterprises every three years and re-assess the generally certified enterprises on an as needed basis, which would demand a higher level of customs management from enterprises.
- Whereas the current assessment and classification procedures are conducted by the Audit Department, it is likely that after the implementation of the Provisional Measures, the Enterprises Administration Department of the local Customs will be the one who is responsible for assessment and classification. Additionally, the Customs will further involve qualified agencies to assist with classification assessments.

KPMG services

To help companies prepare themselves for the expected changes in the regulations regarding the credit management of enterprises, KPMG can assist them with the followings:

- Conducting customs compliance reviews on customs clearance operations and practices, including declared value, goods classification, country of origin, foreign exchange management, prohibited or restricted goods for import/export, transaction models in special Customs zones and royalty payments etc.
- Review internal control in respect of general trade management, management of imported equipment which subject to tax reduction or exemption treatment, import/export license and inspection management.
- Perform review on their internal control of trade and logistics from the aspects of organizational structure control, information system control and internal audit control.
- Assist enterprises with their classification application as an agency by implementing standardized field examinations, advising on areas for improvement, and submitting the assessment report.

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