

# China Tax Alert

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## The Customs of the People's Republic of China Issued New Rules on Tax Collection and Price Verification of Imported Aircraft

### Regulations discussed in this issue:

- Recently, the General Administration of Customs (GAC) has passed the Announcement of the General Administration of Customs on Issues Concerning Collection of Taxes on Maintenance Guarantee for Aviation Supplies (Announcement of the General Administration of Customs [2016] No. 6) and the Announcement on Revising the Relevant Provisions on the Assessment and Determination of the Duty-paid Value of Aircraft under Operating Leases (Announcement of the General Administration of Customs [2016] No. 8). The two announcements were published and implemented on 29 January, 2016.

### Background

Production factors required for the normal operation of airline companies are mainly various aviation equipment for management and operation. Most of the aviation equipment is high-tech product of relatively high value. Therefore, a considerable amount of the import tax paid by airline companies are incurred due to maintenance of aviation equipment. Before the introduction of Announcement No. 6, methods for the classification and administration of tax collection of imported aviation supplies with maintenance guarantee were not unified among local customs to facilitate tax collection. Furthermore, understanding towards and handling of price-verification of the maintenance and overhaul fees at the end of aircraft leasing differed among local customs. Such institutional defect has become a bottleneck for the import and export of aviation supplies with maintenance guarantee, which has increased customs clearance costs, lowered clearance efficiency and raised the hidden risk of profit loss caused by failure of provision of aviation supplies with maintenance guarantee on a timely basis. Therefore, to standardise law enforcement and regulate the management of the import of aviation supplies with maintenance guarantee, the GAC drafted and issued Announcement No. 6 to provide practice guidelines for the law enforcement of local customs and the import and export business of aviation supplies with maintenance guarantee.

Announcement No. 8 is an amendment to the Announcement on Issues concerning Customs Duty of Related Costs of Aircraft Leasing (Announcement of the General Administration of Customs [2010] No. 47) and the Announcement on Further Clarifying Issues concerning Customs Duties of Related Costs of Aircraft Leasing (Announcement of the General Administration of Customs [2011] No. 55). The recent

development of new types of aviation business and the interaction between local customs and enterprises regarding customs clearance has suggested that announcements No.47 and No.55 are not practical enough, fail to adapt to the development of new types of business and fall behind the actual needs. To meet the development of aviation industry and make the policies more practical, the GAC drafted and published announcement No.8 based on such two announcements.

## **Main contents**

### *Analysis of Announcement No.6:*

Announcement No.6 clarifies two important principles for the administration of tax collection of aviation supplies with maintenance guarantee. Firstly, instead of taxing the actual imported and exported aviation equipment, the Customs imposes tax on the maintenance guarantee fees paid under the maintenance guarantee contract; Secondly, the maintenance guarantee fees allocated for the physically imported and exported aviation supplies shall be treated as dutiable value and subject to taxation. In addition, airline companies shall also pay attention to the followings of Announcement No.6:

- The Announcement clarifies the definition and tax scope of maintenance guarantee for aviation supplies and stipulates that the two kinds of maintenance guarantee – repair and replacement of damaged aviation supplies, are both under the scope of the Announcement. Administration of tax collection is based on contracts and the taxing period is determined based on the payment cycle of maintenance guarantee fees.
- Domestic airlines shall voluntarily declare their business of maintenance guarantee for aviation supplies, and local customs shall review such declaration. Local Customs exercise integrated management of airline companies, including pre-registration and post verification. If more than one competent customs are involved, the local customs shall be in charge.
- The Announcement clarifies that the Customs shall impose tax on the maintenance guarantee fees paid under the maintenance guarantee contract, rather than on the actual imported and exported aviation supplies. The Customs shall regulate the air materials physically imported and exported based on the method of “repairing items” and impose tax on maintenance guarantee fees allocated to the aviation supplies physically imported or exported during each period. The taxing period is determined based on the instalments of maintenance guarantee fees agreed by domestic airline companies under the maintenance guarantee contract.
- The Announcement stipulates that imported aviation supplies with maintenance guarantee shall be declared under “1300 repairing items”. During the declaration, airline companies need to provide the Form of Maintenance Guarantee of Aviation Supplies and the List of Declaration for Maintenance Guarantee Fees of Aviation Supplies. Based on these materials, the Customs will collect tax and handle clearance procedures.

- The Customs imposes tax on the maintenance guarantee fees allocated to individual aviation supplies imported and calculates tax based on the tax rate determined by the HS Code of the individual aviation equipment, replacing the previous calculation method which based on the average tax rate of all aviation supplies imported during current period.
- The Announcement also clarifies tax collection methods under special maintenance guarantee fee adjustments, such as hourly fee adjustment, maintenance and overhaul fees, and maintenance guarantee contract change and so on. Airlines should report and file such situations on a timely basis according to the Announcement.

#### *Analysis of Announcement No.8:*

The Announcement clarifies the price-verification issues based on recent development of aircraft leasing industry and requirements of Announcement No. 6, and make its provisions more rigorous and practical. Main points are listed as follows:

- The Announcement clarifies its scope of application, which is only applicable to aircraft under operating leases. As for price verification issues of finance lease, the Measures of the Customs of the People's Republic of China for the Assessment and Determination of the Dutiable Value of Importing and Exported Goods (hereinafter referred to as "the Measures") shall be applied.
- According to the Announcement, overseas payment borne by the lessee should be included in the dutiable value according to the Measures.
- The Announcement replaces industry names such as Overhaul Reserve Fund with detailed description of specific business behaviour in order to solve the problems caused by unclear definition to law enforcement and enterprise tax payment, and to make the policy more targeted and practical.
- The Announcement clarifies the following price-verification issues of dutiable value:
  - The maintenance and overhaul fees, whether incurred at home or abroad, shall be included in the duty paid price as rent.
  - Where the maintenance margin of the lessee is not returned at the end of aircraft lease, the rent shall be included in the duty paid price.
  - The insurance expenses other than those related to normal operation borne by the lease during the lease period fall within the scope of indirectly paid rent and shall be included in the duty paid price.
  - Specifies the types of domestic withholding taxes necessary for tax collection, including the rent agreed under the contract, and withholding tax, business tax, value-added tax borne by the lease for the lessor, which shall be included in the duty paid price.

- Deletes certain operational requirements, such as the filling methods of declaration form, conditions for the import of materials taxed under repairing items to reflect the principle of the Announcement.

## **KPMG observations**

### *GAC Announcement No.6:*

- The introduction of GAC Announcement No.6 improves the protection system of reliance interest of airlines and facilitates customs clearance and tax payment of aviation supplies with maintenance guarantee. At the same time, it increases responsibility of airlines, requiring them to properly keep and manage the related documents necessary for tax payment, such as the Form of Maintenance Guarantee of Aviation Supplies, the customs declaration form for imported and exported aviation supplies and attached documents, invoices of maintenance fees and related contracts.
- The GAC Announcement No.6 sets out different processes and time limits for tax payment of airlines, such as declaration of imported and exported aviation supplies and tax declaration of the maintenance guarantee fees. Announcement No.6 also establishes tax collection methods of the maintenance and overhaul fees and allocation methods of maintenance guarantee fees, which calls for enhanced internal control system of the import and export of airlines.

### *GAC Announcement No.8:*

- GAC Announcement No.8 maintains and improves relevant provisions of previous announcements No.47 and No.55. During the start-up stage, enterprises still need to pay attention to the retrospective effect of the regulations, which is mainly the following three aspects:
  - For the maintenance and overhaul completed before the implementation of this Announcement, if the maintenance fees, whether incurred at home or abroad, shall be borne by the lessee as agreed in the aircraft leasing contract, such fees shall be included in dutiable value as rent.
  - For the domestic tax that has been paid before the implementation of the Announcement, enterprises shall handle the domestic tax based on Announcement No.8.
  - For the insurance fee that has been paid before the implementation of the Announcement, different measures shall be applied depending on the circumstances. If all-risk insurance for the fuselage and separate parts, third party liability insurance and operational risk insurance in the insurance policy cannot be divided, the insurance fee shall not be included in the dutiable value of rent according to the requirements of previous Announcement No.47. Apart from this, the insurance fee shall be handled according to article 5 of Announcement No.8.

These two announcements gradually improves and updates customs regulation on airline business and resolves the problems such as unstandardized law enforcement between different Customs, lack of management regulations, and the failure to adapt to the development of new-style industry. It also reflects the trend towards standardised regulation of the development and management of airline business at the national level. Considering the retrospective effect of the policies, related enterprises shall also focus on potential customs inspection risk.

## **KPMG Services**

### *For Announcement No.6:*

- Provide professional advisory services for airlines with maintenance guarantee business for aviation supplies, point out the risks associated with customs business and assist enterprises with the assessment and review of information system, procedure arrangement and the internal control system.
- Provide advisory services regarding the procedures of registration, deregistration and filling of maintenance guarantee business of aviation supplies.
- Assist airlines with issues related to classification and price-verification appeared in the course of customs clearance.
- Assist airlines to estimate and calculate customs duty involved in the business of maintenance guarantee for aviation supplies and offer the most economical solution.
- As airlines shall re-register with the Customs within 3 months from 29 January 2016 for the maintenance guarantee contracts which have been filed to the Customs before the implementation of the Announcement, KPMG can provide support and advisory services regarding the retrospective effect of this Announcement.

### *For Announcement No.8:*

- Analyse and assess relevant regulations on national aviation leasing industry comprehensively. Provide policy advisory services for strategic development and business arrangement.
- Provide advisory services regarding the aircraft leasing business, related import and export business, conclusion of contracts, business operations and procedure optimisation.
- Assist enterprises with the calculation of related rent and tax fees in the aviation leasing business, provide relevant tax advisory services and the most economical solution.
- Assist enterprises with customs issues of classification and price verification appeared in the aircraft leasing business.

**Khoonming Ho**

Partner in Charge, Tax  
China and Hong Kong SAR  
Tel. +86 (10) 8508 7082  
khoonming.ho@kpmg.com

**Beijing/Shenyang****David Ling**

Tel. +86 (10) 8508 7083  
david.ling@kpmg.com

**Tianjin****Eric Zhou**

Tel. +86 (10) 8508 7610  
ec.zhou@kpmg.com

**Qingdao****Vincent Pang**

Tel. +86 (532) 8907 1728  
vincent.pang@kpmg.com

**Shanghai/Nanjing****Lewis Lu**

Tel. +86 (21) 2212 3421  
lewis.lu@kpmg.com

**Chengdu****Anthony Chau**

Tel. +86 (28) 8673 3916  
anthony.chau@kpmg.com

**Hangzhou****John Wang**

Tel. +86 (571) 2803 8088  
john.wang@kpmg.com

**Guangzhou****Lilly Li**

Tel. +86 (20) 3813 8999  
lilly.li@kpmg.com

**Fuzhou/Xiamen****Maria Mei**

Tel. +86 (592) 2150 807  
maria.mei@kpmg.com

**Shenzhen****Eileen Sun**

Tel. +86 (755) 2547 1188  
eileen.gh.sun@kpmg.com

**Hong Kong****Karmen Yeung**

Tel. +852 2143 8753  
karmen.yeung@kpmg.com

**Northern China****David Ling**

Partner in Charge, Tax  
Northern China  
Tel. +86 (10) 8508 7083  
david.ling@kpmg.com

**Vaughn Barber**

Tel. +86 (10) 8508 7071  
vaughn.barber@kpmg.com

**Andy Chen**

Tel. +86 (10) 8508 7025  
andy.m.chen@kpmg.com

**Yali Chen**

Tel. +86 (10) 8508 7571  
yali.chen@kpmg.com

**Milano Fang**

Tel. +86 (532) 8907 1724  
milano.fang@kpmg.com

**Tony Feng**

Tel. +86 (10) 8508 7531  
tony.feng@kpmg.com

**John Gu**

Tel. +86 (10) 8508 7095  
john.gu@kpmg.com

**Helen Han**

Tel. +86 (10) 8508 7627  
h.han@kpmg.com

**Naoko Hirasawa**

Tel. +86 (10) 8508 7054  
naoko.hirasawa@kpmg.com

**Josephine Jiang**

Tel. +86 (10) 8508 7511  
josephine.jiang@kpmg.com

**Henry Kim**

Tel. +86 (10) 8508 5000  
henry.kim@kpmg.com

**Li Li**

Tel. +86 (10) 8508 7537  
li.li@kpmg.com

**Lisa Li**

Tel. +86 (10) 8508 7638  
lisa.h.li@kpmg.com

**Thomas Li**

Tel. +86 (10) 8508 7574  
thomas.li@kpmg.com

**Simon Liu**

Tel. +86 (10) 8508 7565  
simon.liu@kpmg.com

**Paul Ma**

Tel. +86 (10) 8508 7076  
paul.ma@kpmg.com

**Alan O'Connor**

Tel. +86 (10) 8508 7521  
alan.oconnor@kpmg.com

**Vincent Pang**

Tel. +86 (10) 8508 7516  
+86 (532) 8907 1728  
vincent.pang@kpmg.com

**Shirley Shen**

Tel. +86 (10) 8508 7586  
yinghua.shen@kpmg.com

**State Shi**

Tel. +86 (10) 8508 7090  
state.shi@kpmg.com

**Joseph Tam**

Tel. +86 (10) 8508 7605  
laiyui.tam@kpmg.com

**Michael Wong**

Tel. +86 (10) 8508 7085  
michael.wong@kpmg.com

**Jessica Xie**

Tel. +86 (10) 8508 7540  
jessica.xie@kpmg.com

**Irene Yan**

Tel. +86 (10) 8508 7508  
irene.yan@kpmg.com

**Jessie Zhang**

Tel. +86 (10) 8508 7625  
jessie.j.zhang@kpmg.com

**Sheila Zhang**

Tel. +86 (10) 8508 7507  
sheila.zhang@kpmg.com

**Tiansheng Zhang**

Tel. +86 (10) 8508 7526  
tiansheng.zhang@kpmg.com

**Tracy Zhang**

Tel. +86 (10) 8508 7509  
tracy.h.zhang@kpmg.com

**Eric Zhou**

Tel. +86 (10) 8508 7610  
ec.zhou@kpmg.com

**Central China****Lewis Lu**

Partner in Charge, Tax  
Central China  
Tel. +86 (21) 2212 3421  
lewis.lu@kpmg.com

**Anthony Chau**

Tel. +86 (21) 2212 3206  
anthony.chau@kpmg.com

**Cheng Chi**

Tel. +86 (21) 2212 3433  
cheng.chi@kpmg.com

**Cheng Dong**

Tel. +86 (21) 2212 3410  
cheng.dong@kpmg.com

**Marianne Dong**

Tel. +86 (21) 2212 3436  
marianne.dong@kpmg.com

**Alan Garcia**

Tel. +86 (21) 2212 3509  
alan.garcia@kpmg.com

**Chris Ge**

Tel. +86 (21) 2212 3083  
chris.ge@kpmg.com

**Chris Ho**

Tel. +86 (21) 2212 3406  
chris.ho@kpmg.com

**Dylan Jeng**

Tel. +86 (21) 2212 3080  
dylan.jeng@kpmg.com

**Jason Jiang**

Tel. +86 (21) 2212 3527  
jason.jt.jiang@kpmg.com

**Flame Jin**

Tel. +86 (21) 2212 3420  
flame.jin@kpmg.com

**Sunny Leung**

Tel. +86 (21) 2212 3488  
sunny.leung@kpmg.com

**Michael Li**

Tel. +86 (21) 2212 3463  
michael.y.li@kpmg.com

**Christopher Mak**

Tel. +86 (21) 2212 3409  
christopher.mak@kpmg.com

**Henry Ngai**

Tel. +86 (21) 2212 3411  
henry.ngai@kpmg.com

**Yasuhiko Otani**

Tel. +86 (21) 2212 3360  
yasuhiko.otani@kpmg.com

**Ruqiang Pan**

Tel. +86 (21) 2212 3118  
ruqiang.pan@kpmg.com

**Amy Rao**

Tel. +86 (21) 2212 3208  
amy.rao@kpmg.com

**Wayne Tan**

Tel. +86 (28) 8673 3915  
wayne.tan@kpmg.com

**Rachel Tao**

Tel. +86 (21) 2212 3473  
rachel.tao@kpmg.com

**Janet Wang**

Tel. +86 (21) 2212 3302  
janet.z.wang@kpmg.com

**John Wang**

Tel. +86 (21) 2212 3438  
john.wang@kpmg.com

**Mimi Wang**

Tel. +86 (21) 2212 3250  
mimi.wang@kpmg.com

**Jennifer Weng**

Tel. +86 (21) 2212 3431  
jennifer.weng@kpmg.com

**Henry Wong**

Tel. +86 (21) 2212 3380  
henry.wong@kpmg.com

**Grace Xie**

Tel. +86 (21) 2212 3422  
grace.xie@kpmg.com

**Bruce Xu**

Tel. +86 (21) 2212 3396  
bruce.xu@kpmg.com

**Jie Xu**

Tel. +86 (21) 2212 3678  
jie.xu@kpmg.com

**Robert Xu**

Tel. +86 (21) 2212 3124  
robert.xu@kpmg.com

**William Zhang**

Tel. +86 (21) 2212 3415  
william.zhang@kpmg.com

**Hanson Zhou**

Tel. +86 (21) 2212 3318  
hanson.zhou@kpmg.com

**Michelle Zhou**

Tel. +86 (21) 2212 3458  
michelle.b.zhou@kpmg.com

**Southern China****Lilly Li**

Partner in Charge, Tax  
Southern China  
Tel. +86 (20) 3813 8999  
lilly.li@kpmg.com

**Penny Chen**

Tel. +1 (408) 367 6086  
penny.chen@kpmg.com

**Vivian Chen**

Tel. +852 (755) 2547 1198  
vivian.w.chen@kpmg.com

**Sam Fan**

Tel. +86 (755) 2547 1071  
sam.kh.fan@kpmg.com

**Joe Fu**

Tel. +86 (755) 2547 1138  
joe.fu@kpmg.com

**Ricky Gu**

Tel. +86 (20) 3813 8620  
ricky.gu@kpmg.com

**Fiona He**

Tel. +86 (20) 3813 8623  
fiona.he@kpmg.com

**Angie Ho**

Tel. +86 (755) 2547 1276  
angie.ho@kpmg.com

**Ryan Huang**

Tel. +86 (20) 3813 8621  
ryan.huang@kpmg.com

**Cloris Li**

Tel. +86 (20) 3813 8829  
cloris.li@kpmg.com

**Jean Li**

Tel. +86 (755) 2547 1128  
jean.j.li@kpmg.com

**Kelly Liao**

Tel. +86 (20) 3813 8668  
kelly.liao@kpmg.com

**Grace Luo**

Tel. +86 (20) 3813 8609  
grace.luo@kpmg.com

**Maria Mei**

Tel. +86 (592) 2150 807  
maria.mei@kpmg.com

**Eileen Sun**

Tel. +86 (755) 2547 1188  
eileen.gh.sun@kpmg.com

**Michelle Sun**

Tel. +86 (20) 3813 8615  
michelle.sun@kpmg.com

**Bin Yang**

Tel. +86 (20) 3813 8605  
bin.yang@kpmg.com

**Lixin Zeng**

Tel. +86 (20) 3813 8812  
lixin.zeng@kpmg.com

**Hong Kong****Ayesha M. Lau**

Partner in Charge, Tax  
Hong Kong SAR  
Tel. +852 2826 7165  
ayesha.lau@kpmg.com

**Chris Abbiss**

Tel. +852 2826 7226  
chris.abbiss@kpmg.com

**Darren Bowdern**

Tel. +852 2826 7166  
darren.bowdern@kpmg.com

**Yvette Chan**

Tel. +852 2847 5108  
yvette.chan@kpmg.com

**Lu Chen**

Tel. +852 2143 8777  
lu.l.chen@kpmg.com

**Rebecca Chin**

Tel. +852 2978 8987  
rebecca.chin@kpmg.com

**Matthew Fenwick**

Tel. +852 2143 8761  
matthew.fenwick@kpmg.com

**Barbara Forrest**

Tel. +852 2978 8941  
barbara.forrest@kpmg.com

**Sandy Fung**

Tel. +852 2143 8821  
sandy.fung@kpmg.com

**Stanley Ho**

Tel. +852 2826 7296  
stanley.ho@kpmg.com

**Daniel Hui**

Tel. +852 2685 7815  
daniel.hui@kpmg.com

**Charles Kinsley**

Tel. +852 2826 8070  
charles.kinsley@kpmg.com

**John Kondos**

Tel. +852 2685 7457  
john.kondos@kpmg.com

**Kate Lai**

Tel. +852 2978 8942  
kate.lai@kpmg.com

**Jocelyn Lam**

Tel. +852 2685 7605  
jocelyn.lam@kpmg.com

**Alice Leung**

Tel. +852 2143 8711  
alice.leung@kpmg.com

**Steve Man**

Tel. +852 2978 8976  
steve.man@kpmg.com

**Ivor Morris**

Tel. +852 2847 5092  
ivor.morris@kpmg.com

**Curtis Ng**

Tel. +852 2143 8709  
curtis.ng@kpmg.com

**Benjamin Pong**

Tel. +852 2143 8525  
benjamin.pong@kpmg.com

**Malcolm Prebble**

Tel. +852 2684 7472  
malcolm.j.prebble@kpmg.com

**Nicholas Rykers**

Tel. +852 2143 8595  
nicholas