

Client Alert

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China Issues New Customs Valuation Regulations

On 25 December 2013, the General Administration of Customs of the People's Republic of China ("**GAC**") issued two new regulations on customs valuation, both effective from 1 February 2014. *GAC Order No. 213* ("**Order 213**"), entitled *Measures of Customs of the People's Republic of China for the Determination of Dutiable Value of Imports and Exports*, will replace the existing regulation with the same title issued under *GAC Order No. 148* on 28 March 2006 ("**Order 148**"). In addition, *GAC Order No. 211* ("**Order 211**"), entitled *Measures of Customs of the People's Republic of China for the Determination of Dutiable Value of Domestic Sales of Bonded Goods*, is an entirely new regulation specifically providing for the valuation of bonded goods sold within the territory of China.

1. Changes to the Customs Value Regulations Under Order 213

(a) Customs may consider the circumstances of a sale in determining the acceptability of transaction value between related parties

Under the previous valuation regulation, *Order 148*, the arm's length nature of a related party transaction value could only be established through comparison to a "test value", which was determined based upon one of the alternative valuation methods, including the value of identical or similar goods sold to unrelated parties, deductive value, and computed value.

Whilst these test values remain a part of the valuation regulation, a new provision may simplify the analysis for both customs and the trade community. Article 18, a provision newly added to the valuation regulation by Order 213, enables Customs to determine the acceptability of a related-party transaction value by examining the circumstances surrounding the sale and its conformity with ordinary business practices in the industry. This "circumstances of sale" test, which is provided for in addition to the existing "test value" method, brings China's evaluation of related party transact values more in line with other major signatories to the *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994* ("**WTO Valuation Agreement**").

(b) Calculation of international freight for imported goods

Order 213 also clarifies that international freight and related costs, which should be included in the dutiable value of imported goods, shall be determined based upon the price actually paid or payable for the international transportation. Where the price actually paid or payable is

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not available, *Order 213* provides that Customs shall use the ordinary costs of transport incurred for similar goods during the same period of time. This methodology replaces methods previously provided for under *Order 148* (e.g., the trucking or railway freight costs are calculated as 1 percent of the FOB (port of exit) value of the imported goods according to *Order 148*).

(c) Commissions in the valuation of exported goods

Commissions borne by the Seller and separately provided for are no longer excluded from the dutiable value of exported goods as was the case under Article 44 of order 148. Under the new Order 213, this provision has been removed. As a result, such commissions borne by the Seller will be included within the declared value and will be dutiable to the extent the merchandise is subject to export duties.

2. Valuation of bonded goods sold domestically under Order 211

Provisions for the valuation of bonded goods sold domestically in the territory of China were previously incorporated within *Order 148*. Under the new Valuation regulations, GAC has issued a standalone regulation – Order 211 – in order to address the valuation questions in respect of such bonded goods. *Order 211* clarifies certain details and excludes certain expenses which may have been originally dutiable in connection with bonded goods sold domestically in China.

Notwithstanding the stand-alone nature of the new regulation for the valuation of bonded goods, *Order 211* incorporates the traditional customs valuation methodologies by reference, providing that where its own provisions are inapplicable, the alternative valuation methods provided under *Order 213* (previously *Order 148*) shall apply. We summarise below the principal provision of *Order 211*.

a) Bonded materials or finished goods (including defective and substandard goods) sold by a contract manufacturer located within the territory of China

Similar to provisions under the previous *Order 148*, if bonded materials or finished goods are sold domestically by a turnkey contract manufacturer (i.e., 進料加工) located within the territory of China, the domestic value shall be based upon the transaction value of the bonded materials initially imported, provided no further processing has been performed. Alternatively, the domestic value shall comprise the transaction value of the bonded materials used by the manufacturer to produce the finished goods, which have been sold domestically within China.

If, however, the manufacturer which sells bonded materials or finished goods is a tolling manufacturer (i.e., 來料加工), the transaction value of identical or similar goods shall be used in lieu of the transaction value of the bonded materials.

Order 211 further provides that, in the scenario of turnkey contract manufacturing, if the bonded materials which are actually used to manufacture a particular batch of finished goods cannot be identified, the manufacturer may use the weighted- average of the transaction values of the materials with the same item number, description and tariff heading, which are imported by the manufacturer under the same manufacturing contract, or within the same recording period of the E-Handbook. If these data are not available, Customs may also use alternative quantifiable and

objective data in connection with the materials imported during the same period of time to derive the weight-average transaction value.

b) Bonded waste and scrap materials, by-products and residue after accidents sold by a contract manufacturer located within the territory of China

Similar to *Order 148*, waste and scrap materials resulting from the manufacture of bonded finished goods, or the residue of the aforementioned goods after accidents, when sold to the territory of China, should be valued based upon the price of the domestic sale.

Order 211 further provides, if only a portion of the materials used to produce the bonded finished goods are imported on a duty-bonded basis, then for customs valuation purposes, the domestic sales price of the by-products or residue should be adjusted according to the percentage of the overall cost of materials represented by the bonded materials.

c) Bonded goods transferred under deep processing and sold by the transferee

Order 211 specifically provides for the valuation of bonded goods transferred under a deep processing arrangement. If the transferee sells the bonded goods to the territory of China, the bonded goods should be valued based upon the price at which they were initially transferred to the transferee.

d) Bonded materials or finished goods sold by a manufacturer located within a customs bonded area

Unlike *Order 148*, *Order 211* provides that the price of a domestic sale is the preferred method to value either bonded materials or finished goods produced using bonded materials, which are sold from a customs bonded area into the territory of China. Alternatively, if the actual domestic sales price is not available, the domestic sales price of identical or similar bonded materials or finished goods may be used.

Notwithstanding the above, if the finished goods are sold from a Bonded Zone (保税区), as opposed to other customs bonded areas, the customs value of the finished goods may also be determined based upon the transaction value of the bonded materials initially imported to manufacture the finished goods, provided the goods are not entirely produced of bonded materials.

e) Bonded scrap, defective or substandard products and by-products sold by a manufacturer located within a customs bonded area

Similar to *Order 148*, waste and scrap material, as well as defective or substandard products and by-products resulting from production within a customs bonded area, should be valued based upon the price of the domestic sale when sold within the territory of China. The downward adjustment for non-bonded materials, which is available in the scenario of similar materials sold by a contract manufacturer located within the territory of China, is not relevant here.

f) Bonded goods imported into a customs bonded area for logistics, inspection and exhibition purposes and sold within the territory of China

For bonded goods imported into a customs bonded area for logistics, inspection or exhibition purposes, *Order 211* provides that they should be valued based upon the price of the domestic sale.

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In addition, *Order 211* provides that the insurance, warehousing, freight and other related expenses incurred within the customs bonded area, if separately identified, may be excluded from the domestic sale price for customs valuation purposes. These expenses, which were originally additions to value required by *Order 148*, are no longer dutiable under *Order 211* to the extent they are not included within the domestic sale price.

g) *Bonded goods for Research and Development ("R&D") in a customs bonded area and sold within the territory of China*

Order 211 provides that the valuation methods for bonded goods manufactured in a customs bonded area also apply to goods used for R&D activities in a customs bonded area, when they are sold within the territory of China.

3. Practical implications

- For multinationals engaged in related-party distribution in China, the transfer pricing between the overseas supplier and the Chinese distributor is often under scrutiny by Customs. With *Order 213* specifically enabling a consideration of the circumstances of sale, companies may have additional bases upon which to establish the acceptability of transaction value, apart from the comparison to a "test value". Customs may also be more amenable to considering additional documents supporting the arm's length nature of the related party transaction overall, which may include sales agreements, evidence of negotiation between the parties and as well as transfer pricing documentation.
- For goods that pass through a customs bonded area for storage before being distributed within the territory of China, the import duty and VAT incurred by the Chinese importer may be decreased, because the logistics expenses incurred within the bonded area are no longer dutiable to the extent not included within the domestic sales price.
- For the sale of bonded goods to customers in the territory of China, *Order 211* provides more clarity on the valuation methods of such transactions than the previous *Order 148*, which heavily relied upon Customs' discretion to devise "reasonable methods" to determine dutiable value. This may help reduce uncertainties in the duty and tax exposures relating to such sales.
- The new decree also brings the valuation of bonded goods more in line with the general valuation methods provided for under *Order 213* (previously *Order 148*). However, it remains unclear whether and to what extent the general valuation rules under *Order 213* would be applicable to the valuation of bonded goods sold domestically. Specifically, *Order 211* makes no reference to adjustments to transaction value, such as royalties or assists associated with the bonded goods. In addition, *Order 211 does not provide for a clear mechanism for resolving valuation disputes arising from the sales it specifically addresses.*

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