



# ALERT

## CHINA

### China Customs in Pursuit of "Assists"

In the first quarter of 2010, China Customs' tax revenue gains from valuation reviews alone amounted to more than USD 300 million. This is an indication of the zealotry of China Customs in pursuing extra revenue through valuation.

In BCIT Alert "China Customs Focuses on Royalties & Related Party Transactions in 2010/11" dated April 6, 2010, we highlighted the fact that China Customs is focusing on royalties and related party transactions in 2010/11. Further to that, identification and inclusion of "assists" used in the manufacture and production of a good is also making a healthy contribution to China Customs' first quarter revenue gains in 2010.

#### Action by Companies

Companies should be aware that it is an offence not to pay the correct duty and value-added tax at the time of import and that the threshold for an offence to be dealt with as a criminal matter rather than an administrative matter is RMB 250,000 (approximately USD 36,565) in evaded revenue and if there is intent. There are also potential penalties, interest on the revenue unpaid, and possible affect on current customs grading which will affect the smooth functioning of the company's operations.

#### What is an "Assist"?

The provisions relating to "assists" are contained in the *Regulations of the People's Republic of China on Import and Export Duties* ("Regulations") and the *Rules of the General Administration of Customs of the People's Republic of China for Determination of the Dutiable Value of Import and Export Goods* ("Rules").

Article 19(4) of the Regulations states that:

*The following costs shall be added to the customs value of imported goods:*

[...]

*(4) the value, apportioned as appropriate, of such goods as materials, components, parts, tools, dies, moulds, consumed materials and similar items, and such services as development, design and associated services undertaken elsewhere*

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*than in the territory of the People's Republic of China where these are supplied by the buyer free of charge or at reduced cost for use in connection with the production and sale of the imported goods to the Customs territory of the People's Republic of China;*

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*The following costs shall be added to the customs value of imported goods:*

*[...]*

*(4) the value, apportioned as appropriate, of such goods as materials, components, parts, tools, dies, moulds, consumed materials and similar items, and such services as development, design and associated services undertaken elsewhere than in the territory of the People's Republic of China where these are supplied by the buyer free of charge or at reduced cost for use in connection with the production and sale of the imported goods to the Customs territory of the People's Republic of China;*

#### Action by Companies (cont'd)

Companies involved in the importation of goods into China should undertake a full review of the valuation of their products to ensure compliance with China's valuation requirements. This is especially critical given the activism of China Customs with regard to valuation issues. And when a company discovers a valuation issue, it should work out the most optimal solution to manage its risk and exposure, including making a voluntary disclosure to China Customs.

Companies can undertake their own valuation reviews or alternatively, engage an experienced external party to assist. However, it may be more effective for companies to seek support from a third party to manage the voluntary disclosure presentation and process.



More specifically, Article 11(2) of the Rules states that:

*In determining the dutiable value of imported goods on the basis of the transaction value, the following costs or value, to the extent that they are not included in the price actually paid or payable for the goods being valued, shall be added:*

*[...]*

*(2) the value of the following goods or services related to the manufacturing and sale within the PRC of the imported goods which are provided by the buyer free of charge or below cost and may be apportioned in the appropriate proportions:*

- i) Materials, components, parts and similar goods included in the imports;*
- ii) Tolls, models and similar goods used in the process of manufacturing of the imports;*

- iii) *Materials consumed in the process of manufacturing of the imports;*
- iv) *Engineering design, technical research and development, craft, drafting and related services required for manufacturing of the imports overseas.*



In other words, the value of the goods and services detailed above shall be added to the value of an imported product for customs duty purposes if such goods and services are:

- i. Provided by the buyer of the imported product;
- ii. Provided free of charge or at reduced cost; and
- iii. Provided for the purpose of producing the product for import and sale in China.



### Treating and Valuing "Assist"

The apportioned value of an "assist" constitutes part of the transaction value of the imported product. First, the value of the "assist" has to be determined and then, the value is apportioned as appropriate to the imported product.



In determining the value of an "assist", the following rules apply:

- i. The value is:
  - The purchase price of acquiring the "assist", if acquired by the buyer from an unrelated seller;
  - The cost of producing the "assist", if produced by the buyer or a person related to the buyer;
  - The leasing cost borne by the buyer, if the assist is obtained through leasing; or
  - The value of tools, moulds and similar goods used in the process of manufacturing the imported product, including the engineering design, technical research, craft and drafting expenses etc.
- ii. The value includes the cost of transporting the "assist" to the place of production.
- iii. The value of "assist" used in producing the imported product is adjusted to reflect use, repairs, modifications, or other factors affecting the value of the "assist". Such "assist" include items as tools, dies, and molds.

One important point to note is that the value of such types of "assist" may need to be adjusted under certain circumstances. For example, if the buyer had used the "assist" before providing it for use to manufacture the imported product, the cost of the "assist" must be adjusted (i.e., reduced from the original cost) to reflect the use. Conversely, any repair or modification done to the "assist" may require an upward adjustment to the value of the "assist".

iv. In the case of engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in China, the value is:

- The cost of obtaining copies of the “assist”, if the “assist” is available in the public domain;
- The cost of the purchase or lease if the “assist” was bought or leased by the buyer from an unrelated person;
- The value added outside China, if the “assist” was produced in China and one or more foreign countries.

The buyer's commercial records will likely be examined when determining the value of an “assist”, especially for such “assists” as engineering, development, artwork, design work, plans, sketches and other such work performed in countries other than China.



To better illustrate (iv), consider the following:

#### Scenario 1

A Chinese buyer supplied detailed designs to the foreign producer of his product. These designs were necessary to manufacture the imported product. The Chinese buyer bought the China-produced designs from an engineering company in China and provided them to his foreign supplier/manufacturer.

Q: Should the customs value of the imported product include the value of the assist (i.e., the designs)?

A: No, design work undertaken in China may not be added to the price actually paid or payable for the imported product.

#### Scenario 2

A Chinese buyer purchased the imported product from a foreign producer. The price actually paid or payable includes the cost of Chinese design incorporated in the product.

Q: Can the cost of the Chinese design be deducted from the price actually paid or payable for the imported product?

A: There is no provision under China Customs laws to deduct such costs from the price actually paid or payable.

#### Scenario 3

A Chinese buyer supplied molds free of charge to the foreign manufacturer/seller of the imported product. The molds were necessary to manufacture the product for the Chinese buyer. Some of the molds were manufactured by a company in China while others were manufactured in a third country.

Q: Should the customs value of the imported product include the value of the molds?

A: Yes. Such costs should be added to make up the transaction value for customs purposes.

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