



Processing trade in China

Processing trade refers to the business activity of importing all, or part of, the raw and auxiliary materials, parts and components, accessories, and packaging materials from abroad in bond, and re-exporting the finished products after processing or assembly by enterprises within mainland China. China has a bonded system on processing trade. Under this system, the amount of materials and components imported for the purpose of processing trade is exempt from tariffs. This document outlines the legal framework of processing trade, the advantage of taxation and customs supervision.

I. General introduction

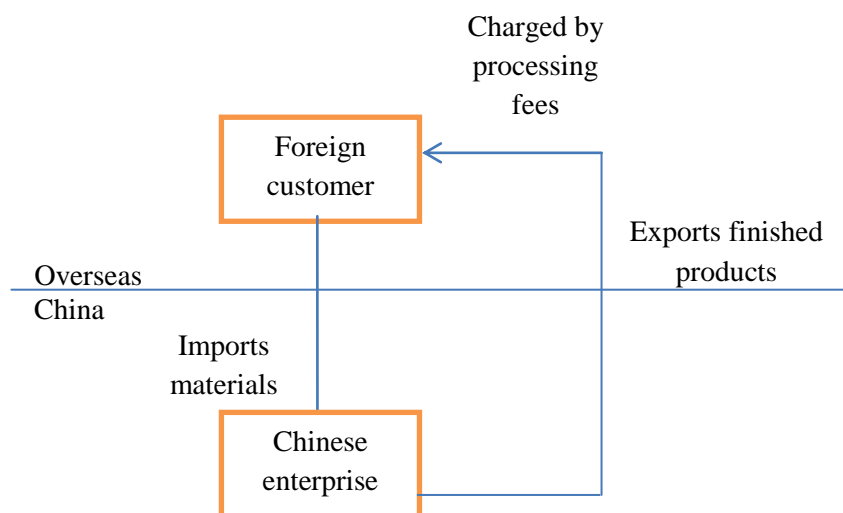
Many foreign companies take advantage of lower land and labour costs as well as tax concessions offered when carrying out processing trade in China. Over the years, processing trade played a vital role in China's economy and its export trade in particular, accounting for approximately 50% of China's total export trade.

Processing trade in China refers to the business activity of importing all, or part of, the raw and auxiliary materials, components and parts, accessories and packaging materials from enterprises abroad to enterprises within China to carry out the manufacturing process. The finished products after processing or assembly by the enterprises within China will be re-exported to the foreign enterprises that are responsible for selling them.

There are two major kinds of processing trade: processing with supplied materials and processing with imported materials.

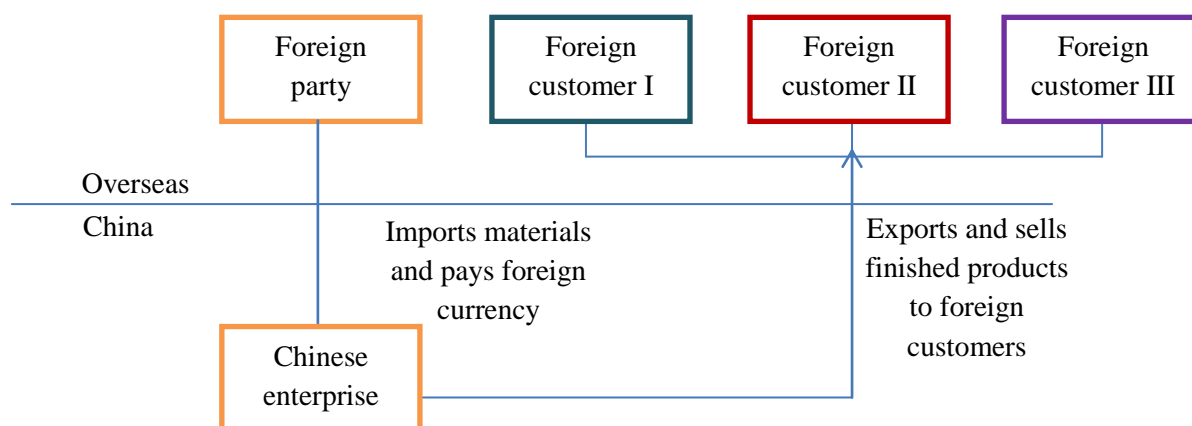
- **Processing with supplied materials**

In terms of processing with supplied materials, raw materials and components are supplied by a foreign company and processed by a Chinese enterprise on a consignment basis. Ownership of raw materials and components remains that of the foreign customer. The Chinese company does not have to make foreign exchange payments, and is paid through charging a processing fee. Finished products are owned and distributed by the foreign customer.



- Processing with imported materials

Processing with imported materials means that a Chinese corporation purchases raw materials and components (either from the ultimate foreign purchaser or a third party). Therefore it has to make foreign currency payments. The ownership of those imported commodities remains that of the Chinese enterprise. The Chinese enterprise exports the finished products to any foreign customer after processing and assembling.



II. Advantage of customs tariff and taxation

China has a bonded system on processing trade that includes bonded zones, factories and bonded warehouses. Under the bonded system, processing companies are entitled to defer payment of tariffs and import-related taxes on all imported materials and components. In that context it does not matter if the materials and components were imported or supplied. The amount of imported materials and components used in the manufacture of the finished products is free from tariffs and import-related taxes. However, if the finished products are intended to be sold on the Chinese market, Chinese customs will levy duties and interest on deferred payments subject to valid approval documents for sale on the Chinese market issued by the relevant authorities.

Furthermore, the imported machines provided by a foreign party for the purpose of processing trade will also be exempt from customs duties and import value-added tax, except for a few non-duty-exempt commodities as specified by the national policies from time to time.

III. Processing status

Under Chinese law, enterprises engaging in processing trade shall be well established with the capacity for processing such as factories, processing equipment and workers. In addition, the Chinese enterprise shall have the rights to deal with import and export business in order to contract with foreign companies. And they are required to obtain a *production capability certification* as well as a *processing trade approval certificate* officially granted by the government authorities.

Chinese companies which plan to enter the processing trade business in an area that requires the use of certain materials such as sugar, vegetable oil, cotton, wool, natural rubber, crude oil or refined oil (which are subject to import quota control) as raw materials, have to ask for approval from the provincial-level commerce authorities at the place of their registration. Other processing trade businesses only require the authorisation of the local commerce authority at the place of registration of the Chinese company.

When a foreign party plans to retain a Chinese enterprise to process or assemble its products, it should be aware of the qualifications of the Chinese enterprise with which it is cooperating.

IV. Customs supervision

To complete the filing and registration process, the Chinese company has to present its *processing trade approval certificate* and *processing trade contract* to the customs office at its seat after receiving authorisation from the commerce authority. It also has to apply for the *processing trade registration handbook*.

Chinese companies must carry out an import-export declaration to customs. This process requires the company to fill out its *registration handbook* and *special customs declaration form for import/export goods for processing with imported materials* (i.e. special customs declaration form), and to present these documents together with the relevant bills of lading, freight notes, packing lists and invoices.

V. Considerations and comments

The processing trade model is clearly an important means of doing business in China for foreign companies, but obviously the legal rules are complex and hard to navigate. Each company's situation will be different and requires a tailored analysis.

Companies outsourcing manufacturing to China are rightfully concerned about how to effectively protect their intellectual property rights. The important thing to remember is that the Chinese legal system does provide some protection for intellectual property rights, and the foreign party shall take advantage of the various protections available. Patents, trademarks, copyrights, and integrated circuit layout designs can be registered. Trade secrets, though broadly and vaguely defined, are also protectable. More information on protection and enforcement of intellectual property rights in China is available on the website of the China IPR SME Helpdesk <http://www.china-iprhelpdesk.eu/>.



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The Centre's range of free services cover:

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- Legal – legal information, 'ask the expert' initial consultations and practical manuals
- Standards – standards and conformity requirements when exporting to China
- HR and Training – industry and horizontal training programmes
- Access to a service providers directory and information databases
- Hot-desking – free, temporary office space in the EU SME Centre to explore local business opportunities
- Any other practical support services to EU SMEs wishing to export to or invest in China.

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