Tax Analysis

PRC Tax

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Free Trade Agreement Signed with Australia

The free trade agreement (CN-AU FTA) signed by China and Australia on 17 June 2015 offers one of the highest levels of overall trade and investment liberalization that China has ever agreed to. The CN-AU FTA provides for major tariff concessions and is expected to enhance both countries' competitive positions in a number of sectors. Australia is one of the largest developed economies to have concluded an FTA with China. This analysis focuses on the trade of goods of the CN-AU FTA.

Tariff concessions

Imports from China to Australia

A zero tariff will be applied to all items within five years after the FTA comes into effect.

- For 91.6% of items (accounting for 81.5% of the total import value from China to Australia), the tariff rate will be reduced to zero on the date the FTA comes into effect;
- For 6.9% of items (accounting for 16.9% of the total import value from China to Australia), the tariff rate will be reduced to zero in the third year after the FTA comes into effect; and
- For 1.5% of items (accounting for 1.6% of the total import value from China to Australia), the tariff rate will be reduced to zero in the fifth year after the FTA comes into effect.

Imports from Australia to China

A zero tariff will be applied to 95% of all items (accounting for 92.8% of the total import value from Australia to China) within five years after the FTA comes into effect, with the percentage eventually increasing to 96.8% (accounting for 97% of the total import value from Australia to China), which is higher than the typical level of around 90% in China's other FTAs.

- For 29.2% of items (accounting for 85.3% of the total import value from Australia to China), the tariff rate will be reduced to zero on the date the FTA comes into effect; and
- For 67.6% of items (accounting for 11.7% of the total import value from Australia to China), the tariff rates generally will be reduced to zero within three, five, six, eight, nine, 10, 12 or 15 years after the FTA comes into effect under a simple linear method.[1]

[1] For example, if the tariff of an item is 10% and will be reduced within five years, it will be reduced year by year (8% in the first year, 6% in the second year, etc.) until the zero tariff in the fifth year.

The following items are excluded from tariff concessions: shark fins, shark fins in airtight containers, wheat, corn, rice, soybean, rapeseed, varieties of oils and fats, some sugar, tobacco, some fertilizers (e.g. urea), some wooden material plates and wooden products, most paper and related products, stamps, commercial prints, some wool, cotton, tobacco processing or manufacturing machines and parts, and OLED screens.

Rules of Origin

Originating goods

To apply for the preferential tariff rates under the CN-AU FTA, the goods must originate from a contracting party. Unless otherwise specified, a good would be considered as originating in a party of the FTA (Party) where:

a) The good is wholly obtained or produced in a Party;
b) The good is produced entirely in a Party or both Parties, exclusively from originating materials; or
c) The good is produced in a Party or both Parties using non-originating materials and it conforms to Annex 2 (i.e. Product-specific rules of origin) and other applicable rules in the chapter of Rules of Origin and Implementation Procedures.

In the context of scenario c), the CN-AU FTA adopts the Regional Value Content (RVC)[2] and Change of Tariff Heading rules.[3]

- For purposes of the RVC rule, the RVC would be calculated as follows: RVC = (V – VNM[4])/V x 100. Depending on the goods involved, the required RVC percentage would be 30%, 40%, 45%, 50% or 60%.
- A change in tariff classification, depending on the goods involved, would include a change to the tariff heading at either the first 2, 4 or 6 digit code.

Annex 2 of the CN-AU FTA contains a special chapter for the Rule of Origin for chemicals (the CN-AU FTA is China's second FTA that includes such a chapter; the FTA with Switzerland also contains a Rule of Origin for chemicals).

Direct transport and non-party invoice

Similar to some of China's other FTAs, for originating goods to be eligible for preferential duty treatment under the CN-AU FTA they must be directly transported between China and Australia.

Goods that have to be transported through one or more third jurisdictions (with or without trans-shipment or temporary storage) still would be considered directly transported between China and Australia if the following requirements are met:

- The goods remain under Customs control in such jurisdictions;
- The goods do not undergo any operation other than unloading and reloading, repacking, re-labelling for the purpose of satisfying the requirements of the importing party, temporary storage or any operation required to keep them in good condition; and
- Where the goods are stored temporarily in such a jurisdiction, the period of storage does not exceed 12 months from the date the goods enter the jurisdiction.

Consignments of originating goods may be split up in a third jurisdiction for further transport, subject to meeting the above requirements.

Where the goods have undergone transit through or temporary storage in a third jurisdiction, the Customs authorities of the importing party may request relevant supporting documents to substantiate whether the direct transport requirement is satisfied.

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[2] The RVC rule requires that a good have a regional value content of not less than a certain percentage to qualify as a good originating from the region.

[3] The Change in Tariff Heading rule requires all non-originating materials used in the production of a good to have undergone a change in tariff classification for the good to qualify as originating from a region.

[4] V is the value of the good, as determined in accordance with the provisions of the Customs Valuation Agreement, adjusted on an FOB basis, and VNM is the value of the non-originating materials.

The CN-AU FTA does not specify whether non-party invoicing (e.g. invoicing by an intermediary in a third country) would be accepted to apply for preferential treatment under the CN-AU FTA. However, according to the filing instruction of the Certificate of Origin, the relevant information (e.g. name, address, country of the operator) must be disclosed in the certificate if the invoice is issued by a non-party operator. It suggests that benefits may not be denied merely because of non-party invoicing, even though additional documents may be required to ensure compliance with other rules of origin requirements.

Export goods in transit

Once the CN-AU FTA comes into effect, the Customs authorities of the importing party should offer preferential tariffs to the originating goods of the exporting party that are in transit from the exporting party to the importing party. The importing party must apply for the preferential tariffs within six months from the effective date of the FTA.

Comments and Recommendations

The signing of CN-AU FTA is a milestone for the cooperative relationship between China and Australia. The two countries are important trade partners and trade and investment has grown rapidly. It is reported that bilateral trade reached USD 136.9 billion, which is 16 times of that in 2000. China has become the largest trading partner, export and import country of Australia.

Table: Top 5 Bilateral Trade Goods in 2014 (By HS Chapter, in Million USD)

Main Chinese goods imported into Australia (2014)				Main Australian goods imported into China (2014)			
HS Chapter	Description	Amount	Total %	HS Chapter	Description	Amount	Total %
85	Electrical appliances, Electrical equipment and sound recorders, and parts and accessories	9,712	20.8	26	Ores, slag and ash	51,423	63.2
84	Nuclear reactors, boilers, machinery and mechanical appliances and parts thereof	9,138	19.5	27	Mineral fuels, mineral oils and products of their distillation, bituminous substances, mineral waxes	7,610	9.4
94	Furniture, bedding, lighting, and prefabricated buildings	2,800	6.0	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof, imitation jewelery, coins	6,340	7.8
73	Iron or steel	2,243	4.8	74	Copper and articles thereof	1,806	2.2
62	Apparel and clothing accessories, not knitted or crocheted	2,177	4.7	51	Wool, fine or coarse animal hair, horsehair yarn and woven fabric	1,512	1.9

Products originating in China that will benefit the most from the CN-AU FTA include clothing, leather, electrical appliances, mechanical products, iron and metal, and chemical products. Products originating in Australia that will benefit the most from the CN-AU FTA include minerals, steel and metal products, as well as agricultural products (e.g. beef, wool and dairy products).

For wool products, China provides nine-year tariff quotas where zero tariffs apply only to imports within the quota of a specific year. China has the right to take special safeguard measures in the form of an additional Customs duty on beef and milk powder (but not infant formula milk powder and special infant formula milk powder) if the imports exceed a certain threshold in a calendar year.

The following table shows the industries that are expected to benefit from the CN-AU FTA.

Industry	Export Country	Related products
Textiles and textile articles	China	Textiles, apparel and leather goods
Machinery and electrical products	China	Boilers, machinery appliances and parts thereof, electrical equipment, television and sound recorders and parts thereof
Chemical	China	Plastic, rubber and chemical products
Miscellaneous manufactured articles	China	Toys, games and sports products, furniture, bedding, lamp and prefabricated buildings
Agricultural products and food	Australia	Beef, dairy, wool, fish and crustaceans, mollusks and other aquatic invertebrates, milk powder and processed food
Spirits and beverages	Australia	wine, spirits and orange juice
Mineral products	Australia	Coking coal, lignite, aluminum oxide, unwrought refined copper and copper alloys, petroleum oil and liquefied natural gas
Medicine	Australia	Medicine, vitamins and health care products

Companies that may be affected by the CN-AU FTA should take the following steps to prepare for the new rules:

- Monitor developments relating to the FTA;
- Identify whether their goods/purchases fall under the schedule of tariff concessions (to do so, a company will need to have the correct HS codes);
- Familiarize themselves with the relevant origin implementation procedures (such as application of the Country of Origin and origin claim requirement);
- Train staff to understand the basic logic for determining HS codes of goods and Rules of Origin for each HS code;
- Evaluate the need to re-structure supply chains (production, sales and purchase) to take full advantage of the preferential duty treatment under the CN-AU FTA;
- Review supply/purchase contracts, in particular with respect to duty clauses relating to liabilities for origin information and application;
- Assemble the appropriate resources to deal with new requirements associated with implementing the FTA (manually and automatically); and
- Establish a regular review mechanism to ensure compliance with the relevant FTA requirements.

How Can We Help

Deloitte's Customs & Global Trade Services Groups in Australia and China have extensive experience in maximizing opportunities under FTAs. Specifically, we can assist companies to:

- Determine the correct HS codes of goods to be exported;
- Determine which HS codes fall within the Tariff Elimination Schedules;
- Assess whether exported goods satisfy the appropriate Rules of Origin to determine whether preferential tariffs can be enjoyed;
- If preferential tariffs are not available, identify steps that can be taken to enable the goods to be exported to qualify for preferential duty treatment;
- Obtain advance rulings from Customs that the products to be exported satisfy the criteria for preferential treatment;
- Obtain certified Preferential Tariff Certificates of Origin from the appropriate approval authorities; and
- Defend any challenges by the Customs authorities as to eligibility to claim preferential duty treatment.

For more information, or to discuss how Deloitte can assist your business, please feel free to contact our Customs & Global Trade Services professional teams.

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