Updated Information of Policies on Freight Forwarding Industry in China

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Tax reform is ongoing and a 12th five year plan target in China.

To enlarge the scope of VAT and reduce BT accordingly is now high on the priority list.

The 12-5 objective of BT to VAT reform intends to gradually phase out BT altogether and replace it with VAT.

In time, all service-oriented industries would also pay VAT, just like manufacturing/secondary industries.
On October 26, 2011, a pilot program of BT to VAT Reform was announced by the State Council:

- Pilot Field: Shanghai, switch from BT to VAT
- Targeted Sectors: Transportation (including road, water, air and pipeline); Modern Services (including logistics support, etc)
- VAT rates: add 11% on transport and 6% on modern services besides current 17% and 13%

On July 31, 2012, BT to VAT applied to 8 provinces and municipal cities, including Beijing, Tianjin, Jiangsu, Zhejiang(including Ningbo), Anhui, Fujian(including Xiamen), Hubei and Guangdong(including Shenzhen).
Benefits to the Logistics Industry

Eliminating Double Taxation

- Under the current tax system, BT applies to each transaction in a supply chain. For enterprises paying BT, the VAT they paid for input materials cannot be used to offset BT; For enterprises using the services of a BT tax payer, the service cost cannot be used to offset their output VAT as well.
- This leads to double taxation. Comparatively, in a VAT system, input VAT can be deducted from output VAT.

Reducing the Risk of Ambiguity

- Sometimes it is difficult to judge whether a complicated transaction falls to BT or VAT, or Both.
- The tax reform unifies the taxation and avoid possible extra tax cost.

More Tax Relief for Lower Margin Logistics Companies

- The VAT paid for input materials and equipments can be deducted, and in certain level to shrink their cost. Higher deductible VAT, higher operating profit.
- Most small and medium logistics enterprises may choose to convert to small-scale VAT payers, paying a low rate of 3% tax on service revenues. It is punitive for transport/logistics where the supply chain is many layered and margins low at each layer.
Problems in Pilot Program

- Tax Increasing Risk with high VAT rate and Low Deductable Input VAT for Transport Companies
- Inconsistent Tax Rates still Exist
- Tax Rate Applied for Express Companies is Ambiguous
- Group Companies cannot Pay VAT on a Consolidated Basis
Problem I: Tax Increasing Risk with high VAT rate and Low Deductable Input VAT for Transport Companies

*Tax burden on support service suppliers such as warehouse operators and freight forwarders has increased mildly;
*While that on companies providing loading/unloading and cargo transport service has increasing risk from 3% to 11%, with low deductible input VAT.

Causes:
*High VAT rate: 3% BT shifts to 11%VAT
*Low VAT input deductibles: only the operating cost for vehicles, fuel and repair is deductible as input VAT, which only account for less than 40% in total cost.
*Other major costs like labor cost, toll fees, house rent and insurance are not deductible.

According to China Federation of Logistics and Purchasing:
*The average tax burden on 65 major Chinese logistics companies was 1.3% during 2008 to 2010 (1.88% for cargo transport).
*In BT to VAT pilot program, the tax burden on cargo transport sector rises to 4.2%, supposed that all VAT-deductable cost is deducted.

*Increased tax burden lowers the profit, which may in turn causes the rise of freight rate, boosting up the commodity price.
*Local authorities have issued temporary policies to offer financial subsidy to enterprises which suffer the rise of taxation. However, this cannot fundamentally solve the problem.
Inconsistent tax rates still exist
- Inconsistent tax items, rates and invoices in every layer of the supply chain restricts the development of the logistics industry.
- As business activities are related, it is difficult to divide transportation service and related support service.
- Tax reform shall consider the uniformity of tax on logistics industry.

Tax rate applied for express companies is ambiguous
- Express companies are identified unclearly as transport companies, freight forwarders or telecommunication companies by local tax authorities.
- This leads to different applied BT rates.
- Under the pilot program, this identity ambiguity still exists, most are assigned 11% VAT rate as transport companies, some are excluded out of the pilot program, where inconsistence and unfairness arises.
- Meanwhile, the major cost of express companies is labor cost which is not deductible, so resulting to heavier tax.
Group companies (parent-subsidiary or parent-branch) cannot pay VAT on a consolidated basis

- According to the implementation rules of pilot program, “two or more taxpayers may pay taxes on a consolidated basis under the approval of Ministry of Finance and State Administration of Taxation”.

- A general practice of large-scale logistics companies is centralized procurement of transport vehicles by parent companies and business operation by subsidiaries or branches.

- Thus the parent companies have considerable input tax balance while the subsidiaries/branches have few to deduct.

- Another situation occurs when a subsidiary forwarding company purchases transport capacity from a subsidiary transport company. The subsidiary forwarding company pays VAT at the rate of 6% and deducts the freight at 11%, thus there will be large amounts of input tax balance; while tax rate for the subsidiary transportation company raises from 3% to 11%, thus taxation will be largely increased.

- If parent companies and its branches and subsidiaries are allowed to pay VATs on a consolidated basis, the taxation will be well balanced.
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Tax Reform
- BT to VAT Reform

Policy Guide
- Guiding Opinions of the Development of Freight Forwarding Industry

Customs Issue
- Pilot Reform of Paperless Customs Clearance
On January 16, 2013, the Ministry of Commerce issued “Guiding Opinions of the Development of Freight Forwarding Industry” (Guiding Opinions), proposing guidelines, principles, targets, tasks and measures to bring the development of freight forwarding industry during “the 12th Five-Year Plan”.

- Industry Situation
- Development Targets
- Fundamental Principles
- Major tasks
Industry Situation

- Up to 2011, the number of registered international freight forwarders in China had exceeded 27,000, with more than 2 million practitioners.

- Compared with those in developed countries, China’s freight forwarding industry is generally characterized as smaller size, less comprehensive functions, less advanced operation means and limited capacity of professional service.
Development Targets

- To reach annual sales growth of 12% for enterprises above the designated size by transforming the business mode and improving the service quality.

- To select and establish several competitive large-scale international logistics enterprises with outstanding core business, advanced management and strong overseas network through M&A.

- To cultivate a number of medium and large-sized logistics enterprises with integrate function, complete facilities and capacity of resource consolidation.

- To develop a group of small and medium-sized forwarding enterprises with popularity, reputation and professional advantage.

- To form an international freight forwarding market with reasonable structure, various forms, quality service and orderly competition.
Guiding Opinions specifies the basic principles as “market driven and government guidance”.

Guiding Opinions stipulates the respective development goal for small and middle-sized freight forwarders and large ones. Small and middle-sized freight forwarders are expected to focus on specialized service while large ones shall transform and upgrade to comprehensive logistics service, under classified guidance and orderly competition.
Major Tasks

- To improve the industry management system.
- To guide the transformation and restructuring of the industry.
- To optimize the market environment and follow closely to the development of SMEs.
- To encourage the expansion and globalization of the enterprises.
- To innovate management pattern and develop emerging markets.
- To improve the information technology level of the industry.
- To strengthen the basic work like statistics and qualification assessment for the development of the industry.
- To reinforce the operation of the industry associations.
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On July 31, 2012, the General Administration of Customs issued Announcement No. 38 [2012], decided to launch a pilot reform program of paperless customs clearance in a nation-wide range from August 1, 2012.

The customs will examine and verify the data of customs declaration and accompanying documents submitted by enterprises through China E-Port, based on the classified management and risk analysis of enterprises, and the classification of imported and exported products according to their risk levels.
## Scope of Pilot

<table>
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| Beijing Customs                   | Imports by air  
| Tianjin Customs                   | Imports by sea  
| Shanghai Customs                  | Imports and exports by sea  
| Nanjing Customs                   | Imports and exports through the special area supervised by the customs  
| Hangzhou and Ningbo Customs       | Imports and exports through customs transit  
| Fuzhou Customs                    | Imports and exports of trades with Taiwan  
| Qingdao Customs                   | Exports by sea  
| Guangzhou Customs                 | Exports by air  
| Shenzhen Customs                  | Exports by land  
| Gongbei Customs                   | Imports by land  
| Huangpu Customs                   | Imports and exports by land through customs transit  

## Pilot Enterprises

Import and export enterprises and customs brokers classified as category AA or A
Process of Paperless Customs Clearance

Paperless Customs Clearance is optional

Contract
Submit E-Docs
Clearance

Pilot Enterprise
Local Customs
Certification Organization (China E-Port)

<table>
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<th>Enterprises</th>
<th>Data of Submitted Documents</th>
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<td>Category AA and eligible to keep docs</td>
<td>May keep the paper documents</td>
</tr>
<tr>
<td>Category AA but not eligible to keep docs</td>
<td>Shall submit paper documents within 10 days after release</td>
</tr>
<tr>
<td>Manufacturing enterprises of category A</td>
<td>Shall submit paper document at the same time</td>
</tr>
<tr>
<td>Other enterprises</td>
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Tips on the Paperless Customs Clearance

- **Declaration Agency:** Both the import & export enterprise and the declaration enterprise should have been allowed by the customs to apply the paperless customs clearance.

- **Publicity of Files:** Relevant units may review or copy filed data of customs declaration and accompanying documents.

- **Temporarily Not Applicable:** Imports and exports concerning permits and licenses (excluding customs clearance permits for imports/exports).

- **Revertible:** Enterprises may change/cancel the paperless clearance measure of certain documents through China E-Port.

- **Prevention and Control:** Imports and exports will be randomly inspected; All of the submitted data will be reviewed after release.
On 8:41 am, August 1, 2012, Baoshan Iron & Steel Co, Ltd. declared a cargo of export cold rolled coils through E-Port. Just 11 seconds later, it received the notice of release from Shanghai Customs.

On August 23, 2012, a Zhejiang company became the first to submit online declaration and the system completed the acceptance of the documents in 31 seconds. On 1:16 pm, Shanghai Customs issued the release notice through the information platform; and the shipment of 7 containers all arrived at Yangshan Port from 11 pm to 5 am of the next day.
The Prospect of Paperless Customs Clearance

- **First Step:** A few enterprises with top qualification and credit are allowed to apply the practice of paperless customs clearance and keep the paper documents.

- **Second Step:** The application range shall be expanded gradually. More and more enterprises with qualification and credit shall be allowed to apply the paperless practice.
Thanks!