

Tax

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Tax Analysis

Chinese Customs Authorities Issue Updated Guidance on Customs Audits

Guidance that became effective on 1 November 2016 updates implementation measures relating to the rules governing customs audits (GAC Order [2016] No. 230¹). The previous version of the implementation measures dating from 2000 was repealed on the same date.

The Chinese Customs authorities generally are empowered to carry out audits on goods for three years from the date the goods are released from customs.²

The State Council amended the nearly 20-year old Customs audit regulations (State Council Order No. 670), with the amended regulations becoming effective on 1 October 2016. The regulations make changes to the audit procedure, formalize the sharing of information obtained during a Customs audit with other government agencies, introduce a voluntary disclosure program and allow qualified third-party professionals to provide opinions during Customs audits. The newly released implementation measures provide additional clarifications on the revised regulations.

The Chinese authorities have launched a series of initiatives in recent years to facilitate and expedite the clearance of goods from Customs. The authorities have shifted their focus to post-import/export administration, in which audits play a key role in ensuring compliance.

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¹ See full text in Chinese: <http://www.customs.gov.cn/publish/portal0/tab49564/info820851.htm>

² If some or all of the goods were bonded or exempt from import tax and, hence, the goods were subject to a Customs monitoring period, the three-year period for initiating an audit will start after the expiration of the original monitoring period.

Highlights of the new measures

The new measures consist of 34 articles in five chapters, including a new chapter entitled "Voluntary Disclosure Program" and two updated chapters (relating to actions Customs can take where noncompliance is identified during an audit) that are consolidated into other chapters. The new measures also refine certain terminology to clarify outstanding issues.

Key changes

- The Customs authorities may engage accounting or tax firms to issue professional opinions to support investigations of the facts of a case. The audited party also can engage a firm whose opinion may be accepted as reference material by the Customs authorities. Where an engaged firm commits fraud, conceals facts or breaches the confidentiality agreement in the audit, the Customs authorities can report this to the relevant professional regulatory bodies.
- Under the new voluntary disclosure program (VDP) in the Customs audit regulations, an enterprise may voluntarily report its noncompliance to the Customs authorities in exchange for a reduction or waiver of penalties. The new measures clarify that an enterprise that applied for the VDP must submit supporting documentation (e.g. financial books or trading documents relating to the noncompliance activities) to the Customs authorities and is responsible for proving the authenticity, accuracy and completeness of such documents. The Customs authorities must verify the information provided by the enterprise and may request additional information if necessary.

Enterprises that successfully apply for the VDP may be exempt from penalties if the noncompliance was insignificant and remedial actions were taken in a timely manner, and no harmful consequences arise from the noncompliance. If the enterprise voluntarily pay the underpaid tax under the VDP, the Customs authorities may waive late payment surcharges.

Application of the VDP will be denied in the following situations:

- § The Customs authorities already had suspicions about the noncompliance before it was voluntarily reported;
 - § The Customs authorities notified the enterprise that it was initiating an audit before the noncompliance was voluntarily reported; and
 - § The information reported by the enterprise is significantly inaccurate or the enterprise concealed other noncompliance issues.
- Previously, an audited party could refuse to receive a Customs notification in an audit. The new measures provide that a notification will be deemed to be received if the delivery of a notification to the main business premises of the audited party was witnessed and signed by other persons or the entire process was recorded and is evidenced by photos and/or videos.

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Miscellaneous

- The carriage and control of Customs-transit goods and the use and control of temporarily imported or exported goods are removed from the scope of customs audits.
- The Customs authorities are empowered to collect information from a variety of sources (e.g. other government departments, trade unions, financial institutions and relevant enterprises) for audit purposes. The information can be collected via onsite visits, interviews, written inquiries, online surveys, etc. The information includes that relating to government administration, general operating information of specific goods (e.g. commercial practice, market structure) of certain enterprises or industries, general data (e.g. structure, composition, function, usage, manufacturing techniques and processes, price, etc.) and other data relating to import/export activities.
- Enterprises generally are required to retain relevant documentation for a three-year period following import/export since the Customs authorities have three years from the date the goods are released from customs to initiate an audit. Because many companies already use IT for operational management purposes, electronic data now must be maintained if the relevant operating information is stored in electronic format.
- Where the required operating information is stored in electronic format, the audited party must provide the data to the Customs authorities and grant access to Customs to the relevant IT system, along with instructions on how to use the system. Where the Customs authorities copied the data to the physical media of the authorities, information relating to the data preparation (e.g. methods, time, responsible person and where the physical media is located, etc.) must be documented, affixed by an official stamp or signed by the preparer and the representative(s) of the audited party.
- Where the Customs authorities photocopy documents supplied by an audited party, the person delegated by the audited party must confirm that the photocopies are consistent with the original documents, and specify the sources, number of pages and the time the photocopies were made, and submit a written statement to the effect that the photocopies are consistent with the original documents and that no errors were discovered after check by the audited party. The photocopies must be affixed with an official stamp or signed by the representative(s) of the audited party. If the documents provided by the audited party are prepared in a foreign language, a Chinese translation must be provided.
- An audit generally will be conducted by the Customs office in the place where the audited party is registered. However, the audit may be conducted by the Customs office at the place where the goods were imported/exported (or where the goods were declared to Customs) if that place is different from the place where the audited party is registered. Subject to approval from the higher Customs authorities (or the GAC), a Customs office may conduct the audit in places that were under the administration of other Customs offices.
- The Customs authorities may seize certain financial books and documents during an audit, and the new measures further empower the authorities to seize physical media (e.g. disks) that was used to store electronic data.
- Where noncompliance is identified during an audit, the Customs authorities will issue a notice and require the audited party to make corrections within a prescribed period of time. If the audited party fails to comply or cooperate with the Customs authorities, the authorities may downgrade the party's Customs compliance rating.
- Previously, the Customs authorities were required to seek comments from the audited party in writing, regardless of whether noncompliance or underpaid tax was identified during an audit. The new measures confirm that such communication is required only if the Customs authorities discovered noncompliance activities or that import taxes were underpaid.
- An audit may be suspended if the responsible party for the audited party is missing or if the audited party is terminated (or liquidated) without a successor; however, approval of the director of the relevant Customs office must be obtained.

- Where the Customs authorities discover during the course of an audit that an audited party failed to set up its financial books, or concealed, falsified or destroyed its financial books, the Customs authorities must disclose this fact to the competent financial departments, such as the local Bureau of Finance.

Deloitte comments

The issuance of the new measures is further evidence that Chinese Customs is focusing on the administration of imported/exported goods, as well as the importers/exporters themselves. Customs audits in the post-import/export stage clearly will be an important component of the new administrative policy. The measures should be welcomed by potentially affected businesses since they provide guidance to local Customs offices to standardize the audit practice, and the formal introduction of VDP and allowing professional firms to issue opinions should encourage compliance, and improve the fairness and efficiency of Customs audits. The Chinese Customs authorities are expected to continue to work to further improve and develop internal guidance relating to Customs audits.

However, companies should take note of the following:

- **Information sharing among government departments:** The new measures allow the Customs authorities to obtain information from various sources and share certain audit findings with other government departments. They also may downgrade the Customs compliance rating if certain noncompliance activities or underpaid tax is identified. These factors would suggest that audited parties may face more intense scrutiny, and noncompliance could have a negative impact on areas beyond Customs (e.g. reputational impacts).
- **Management of electronic data:** Acknowledging that many companies have heavily relied on IT in their daily operations, the Customs authorities clarified that electronic data may be subject to the Customs requirements for maintenance, collection and reproduction. While the use of electronic data may help to facilitate the audit process, affected companies should maintain and manage such data to avoid any risk that could arise if the data is lost.

Despite the clarifications in the new measures, some practical issues still need to be addressed (e.g. the extent to which documents prepared in foreign languages must be translated into Chinese). Companies should continue to closely monitor regulatory and practice development.

Taking into account the new Customs regulations and clarifying measures, enterprises should take the following actions:

- Improve the compliance management of the supply chain with a view to upgrading the Customs compliance rating to enjoy a speedier Customs clearance procedure;
- Strengthen the internal management of documents and data, perform regular assessments to identify any potential areas of noncompliance in a timely manner and leverage the VDP to mitigate risk; and
- Deal with Customs audits or self-examinations appropriately and seek professional advice where necessary.

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