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## RSM Tax Advisory (Hong Kong) Limited

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Welcome to Tax Flash – RSM Tax Advisory (Hong Kong) Limited's Newsletter Covering Technical Development in Taxation

### IMPACT OF TRADE DISPUTES BETWEEN CHINA AND US

*Starting from March 2018, China and US began to exchange threats relating to the imposition of additional tariffs on billions of dollars of trade in goods. Several lists of affected goods were already released by the China and US governments throughout the months from April 2018 to August 2018.*

*On 1 March 2018, the US announced that it would levy customs duty of 25% on steel and 10% on aluminum from several trade partners in response to the Section 232 investigation. Following this, the US proposed a 25% customs duty on US\$50 billion worth of Chinese goods on 23 March 2018 under Section 301. The proposed list was published on 4 April 2018.*

*In response to the above actions taken by the US, China has retaliated by imposing additional customs duty of 15% or 25% on 128 types of goods originating from the US, with effect from 2 April 2018.*

*The above series of actions unfold the China and US trade disputes, followed by a sequence of events that occurred in the past few months.*

*In this Tax Newsletter we aim to provide you with the latest development of the China and US trade disputes and lists of goods/ industries being affected.*

#### 1. BACKGROUND

There has always been a trade imbalance between China and the US over the last decade with the US having a huge trade deficit which US President Donald Trump has promised to reduce. According to the US statistics, the US trade deficit with China was \$376 billion in 2017, which exists because the US exports to China were only \$130 billion while imports from China amounted to \$506 billion. The US

government relates such trade deficit with the protectionist policies adopted by the Chinese government, which favour domestic companies in China allowing them to manufacture at a lower cost, thus raising the competitiveness of their exported goods. President Trump also claims that China has artificially undervalued the Chinese Yuan by 15 percent to 40 percent and he asked that China should put in more effort to raise its exchange rate.

In addition, the US government also criticizes the requirements imposed by the Chinese government on foreign technology companies when establishing companies in China. The foreign technology companies have to link up with domestic Chinese partners and share their technology with them. Under such an arrangement, the technology and know-how developed by the US and foreign companies would be indirectly transferred to domestic companies in China. The US government views this as an unauthorized use of US intellectual property by China.

Following the US Trade Representative's Section 301 investigation criticizing China's policy on technology, intellectual property and innovation, President Trump announced in March 2018 that the US will impose tariffs on approximately \$50 billion worth of Chinese imports and take other actions in response to China's policies that coerce American companies into transferring their technology and intellectual property to domestic Chinese enterprises. These policies bolster China's stated intention of seizing economic leadership in advanced technology as set forth in its industrial plans, such as "Made in China 2025."

These above issues have fuelled the tension between China and the US, which lead to the trade disputes between China and the US, as well as the series of retaliating acts from both countries for protecting their domestic industries.

## 2. DEVELOPMENT OF TRADE DISPUTES BETWEEN CHINA AND US

The sequence of events throughout March 2018 to August 2018 is as follows: -

Date	Actions taken by China	Actions taken by the US
1 March		The US government announced to impose additional tariff of 25% on imported steel and 10% on imported aluminum (under Section 232 investigation). The additional tariff has been imposed since 23 March 2018.
23 March		The US government announced on 23 March 2018 under Section 301 proposing a 25% tariff on US\$50 billion worth of Chinese goods.
1 April	The Tariffs Commission of the PRC State Council issued "Circular on Suspending the Customs Duty Reduction for Certain Imported Goods Originating from the US", which has been effective since 2 April 2018.  Existing preferential customs duty rate on 120 types of imported products from the	

	US such as wine, apples, ethanol, stainless steel pipes etc. would be suspended and an additional 15% customs duty rate would be imposed. For another 8 types of imported goods from the US, such as fresh and frozen pork and aluminum scrap, the existing preferential customs duty rate would be suspended, and an additional 25% customs duty rate would be imposed.	
<b>4 April</b>	The PRC State Council issued Public Notice [2018]34 on April 4 in relation to tariff treatment on certain items originated from the US. The effective date of this notice is to be announced.	The US released the first list of 1,333 types worth US\$50 billion Chinese products subject to additional tariff.
<b>15/16 June</b>	<p>The PRC State Council issued the “Announcement on Imposing Additional Tariffs on USD50 Billion Worth of Imported Commodities Originated from the US” on June 16, 2018.</p> <p>According to the Announcement, China will impose additional 25% tariffs on 659 types of imported goods from the US. The additional 25% tariffs will be applied on 545 types of products (including agricultural, automotive and aquatic products) with worth of around USD 34 billion from July 6, 2018.</p> <p>The effective date for the remaining 114 types of products (including chemical, medical and energy products) will be announced later separately.</p>	<p>The US government has issued two lists of items subject to additional tariff (under Section 301 investigation). The first list contains 818 types of the original 1,333 types that were included in the proposed list released in April 2018 while the second list is a proposed list which contains 284 types of products. The first list has been effective since 6 July 2018.</p> <p>These two lists generally cover products which benefit from China industrial policies, including the “Made in China 2025” industrial policy. The major industrial sectors which will be affected include aerospace, information and communications technology, robotics, industrial machinery, new materials, and automobiles.</p>
<b>8 August</b>	The PRC government has released a list of products which will be subject to additional customs duty rate of 25% from 23 August 2018.	The US government announced that an additional tariff of 25% will be imposed on 279 types of original 284 types of products that were included in the proposed list released on 15 June. The additional tariff will be effective from 23 August 2018.

The types of products covered under the above lists released by China and US and the corresponding effective dates as announced for the imposition of additional customs duty are summarized in the following table: -

Effective Date	Types of products covered	
	Imposed by the Chinese Government	Imposed by the US Government
<b>23 March 2018</b>		Aluminum and steel
<b>2 April 2018</b>	Wine, apples, ethanol, stainless steel pipe, fresh and frozen pork and aluminum scrap	
<b>6 July 2018</b>	Agricultural, automotive and aquatic products	Aircraft, industrial parts, machinery, motors, telecommunication equipment, automotive
<b>23 August 2018</b>	Chemical products, medical and energy products	Chemical products, machinery, automotive

Please refer to the web site links for the complete list of affected products issued respectively by the government of China and the US in the last section of this newsletter, and note that there are still product types which would be subject to additional tariff with the effective date yet to be announced.

### 3. EXCLUSION MECHANISM IN THE US

There are certain exclusions to the additional tariffs provided by the US government.

#### a. Section 232 Exclusion

##### Country-based exclusion

**Temporary waivers** have been granted to Canada, Mexico, Australia, Argentina, Brazil and member countries of the European Union. These temporary waivers were already expired on 31 May 2018.

South Korea, Argentina and Brazil are permanently exempted from the tariffs on steel imports after agreeing to a quota to limit its steel exports to the US.

Argentina is also permanently exempted from the tariffs on aluminum imports after agreeing to a quota to limit its aluminum exports to the US.

Australia is currently the only country to have maintained a country-based exemption without having to agree to a quota on its export volume.

### Product-based exclusion

The US government grants exclusions from the additional tariff for domestic parties affected by the special tariff if it is determined that the steel or aluminum article for which the exclusion is requested satisfies the following conditions:

- not produced in the United States in a sufficient and reasonably available amount or of a satisfactory quality, or
- should be excluded based upon specific national security considerations.

Only individuals or organizations using the steel or aluminum articles in a business activity (*e.g.* construction, manufacturing, or supplying steel or aluminum to users) in the United States may submit exclusion requests.

Approved exclusions will be made on a product basis and will be limited to the individual or organization that submitted the specific exclusion request.

Exclusions will generally be approved for one year, requiring renewal of application for exclusions beyond the one-year period.

Exclusions granted are retroactive on imports to the *date the request for exclusion was posted for public comments*. Applicants can request a refund of additional tariff for previous imports of the excluded products.

## **b. Section 301 Exclusion**

### Product-based exclusion

The US government allows all interested parties, including trade associations, to submit requests for exclusion from the additional tariff imposed under Section 301 investigation by 9 October 2018 the latest. The exclusion granted will be valid for one year.

The request for exclusion should address the following factors: -

- Whether the particular product is available only from China. In addressing this factor, requestors should address specifically whether the particular product and/or a comparable product is available from sources in the United States and/or in third countries.
- Whether the imposition of additional duties on the particular product would cause severe economic harm to the requestor or other US interests.
- Whether the particular product is strategically important or related to “Made in China 2025” or other Chinese industrial programs.

## **POINTS TO NOTE**

The China and US trade disputes is evolving continuously, and it is unlikely that the additional tariff imposed by the US on goods from China and vice versa will be removed within a short period of time. It is therefore worthwhile for the affected companies to identify possible means to mitigate the adverse impact brought forth.

Some possible mitigating measures are outlined below: -

#### 1. Application for exclusion

The US government allows eligible parties to apply for exclusion from additional tariff for specific product types, subject to satisfaction of certain criteria set forth by the US government. Please refer to Section 3 above for a general overview of the requirements.

The exclusion criteria as set out under Section 232 Exclusion mainly cover steel and aluminum products. For other products, e.g. agricultural products, chemical products, industrial parts, etc., the exclusion criteria as set out under Section 301 Exclusion should be referred.

#### 2. Use of proper tariff code

The first 6 digits shall be the same globally, but different countries have different codes for the remaining 4 digits. A detailed review on tariff codes shall be performed to confirm if the correct HTS codes have been used for import declaration. In some instances, the components of a certain product may fall under different tariff codes and subject to different tariff rates if import separately.

#### 3. Operational restructuring

As an international practice, where two or more countries are involved in the production of goods, the last country where “substantial transformation” takes place would be the country of origin for the finished goods. It is advisable to evaluate if it is feasible to adjust production arrangement in order to change the country of origin of the finished goods.

#### 4. First sale duty-saving strategy

“First Sale” is a customs duty saving strategy which allows an importer to reduce the amount of duty it pays for goods imported into the US.

In a multi-tiered transaction structure, an importer may use the factory’s invoice price for Customs duty declaration purposes instead of the vendor’s invoice price.

Nevertheless, there are certain conditions that must generally be fulfilled in order to apply the “Transaction Value” in sales between a foreign manufacturer and a foreign vendor as enumerated in an earlier court case. These factors are: -

- Goods are destined to the US
- Two “Bona Fide” sales for export
- Transaction must be at arm’s length

As there are product types which would be subject to additional tariff but the effective date has not yet been announced by the respective government and in view of the significance in the impact on businesses, companies should continue to monitor the development of the China and US trade disputes and proactively consider if any cost saving measures would be feasible.

## REFERENCES

The complete list of affected products issued by China and US on respective date is as follow: -

Date of issue	Relevant links
<b>1 March 2018</b>	<b>US:</b> <a href="https://www.cbp.gov/trade/programs-administration/entry-summary/232-tariffs-aluminum-and-steel">https://www.cbp.gov/trade/programs-administration/entry-summary/232-tariffs-aluminum-and-steel</a>
<b>1 April 2018</b>	<b>CHINA:</b> <a href="http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201804/t20180401_2857769.html">http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201804/t20180401_2857769.html</a>
<b>4 April 2018</b>	<b>US:</b> <a href="https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/april/under-section-301-action-ustr">https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/april/under-section-301-action-ustr</a> (page 14 of the notice)  <b>CHINA:</b> <a href="http://images.mofcom.gov.cn/www/201804/20180404161059682.pdf">http://images.mofcom.gov.cn/www/201804/20180404161059682.pdf</a>
<b>15 June 2018</b>	<b>US (List 1):</b> <a href="https://ustr.gov/sites/default/files/enforcement/301Investigations/List%201.pdf">https://ustr.gov/sites/default/files/enforcement/301Investigations/List%201.pdf</a>  <b>US (List 2):</b> <a href="https://ustr.gov/sites/default/files/enforcement/301Investigations/List%202.pdf">https://ustr.gov/sites/default/files/enforcement/301Investigations/List%202.pdf</a>
<b>16 June 2018</b>	<b>CHINA (List 1):</b> <a href="http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201806/P020180616034361843828.pdf">http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201806/P020180616034361843828.pdf</a>  <b>CHINA (List 2):</b> <a href="http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201806/P020180616034362364988.pdf">http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201806/P020180616034362364988.pdf</a>
<b>8 August 2018</b>	<b>US:</b> <a href="https://ustr.gov/sites/default/files/enforcement/301Investigations/Final%20Second%20Tranche.pdf">https://ustr.gov/sites/default/files/enforcement/301Investigations/Final%20Second%20Tranche.pdf</a>  <b>CHINA:</b> <a href="http://218.189.123.39/videoplayer/P020180808696052416638.pdf?ich_u_r_i=8b4a716371b1755df75a7fa5415f4fa2&amp;ich_s_t_a_r_t=0&amp;ich_e_n_d=0&amp;ich_k_e_y=1845088920750663542448&amp;ich_t_y_p_e=1&amp;ich_d_i_s_k_i_d=1&amp;ich_s_e_q=1853475431&amp;ich_u_n_i_t=1">http://218.189.123.39/videoplayer/P020180808696052416638.pdf?ich_u_r_i=8b4a716371b1755df75a7fa5415f4fa2&amp;ich_s_t_a_r_t=0&amp;ich_e_n_d=0&amp;ich_k_e_y=1845088920750663542448&amp;ich_t_y_p_e=1&amp;ich_d_i_s_k_i_d=1&amp;ich_s_e_q=1853475431&amp;ich_u_n_i_t=1</a>

## RSM Tax Advisory (Hong Kong) Limited

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- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
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