

# China Indirect Tax Alert



## Framework agreement signed between mainland China and Taiwan - "Early Harvest" to be implemented

After a series of lengthy negotiations, negotiators from mainland China and Taiwan signed the Cross Straits Economic Cooperation Framework Agreement (ECFA) on 29 June 2010, a move hailed by many as a milestone in Cross Strait relations.

### Summary of ECFA

The ECFA slightly differs from a typical free trade agreement (FTA) familiar to many. A framework agreement shapes future agreements by focusing on the structure and objectives before negotiating the eventual content. The ECFA has been negotiated to include an 'Early Harvest' list, which allows certain critical industries to be eligible for early tariff reductions and preferential market access.

The objectives of the ECFA are to improve and strengthen economies, trade (goods and services) and investment opportunities between the signing parties. It is intended that the ECFA will gradually reduce and remove trade and investment barriers and create a fair environment for both Mainland China and Taiwan. The Agreement also provides protection for Cross Strait investments to boost two-way capital flows.

The ECFA contains 16 Articles which cover the following topics: Objectives, Cooperative Measures, Trade and Investment Framework, Economic Cooperation Framework, Early Harvest for Trade in Goods and Services and Dispute Settlement Procedures.

There are five Annexes to the current ECFA:

- ▶ **Early Harvest List for Trade in Goods**
- ▶ **Provisional Rules of Origin** pertaining to the Early Harvest List for Trade in Goods
- ▶ **Trade Protective Measures** pertaining to the Early Harvest List for Trade in Goods
- ▶ **Early Harvest List for Trade in Services** for Relevant Sectors and Liberalization Measures
- ▶ **Definition of Service Providers** under relevant sectors and liberalization measures pertaining to the Early Harvest List for Trade in Services

Following the ECFA signing, both parties will need to complete ratification procedures and provide written notification to the other party. Once written notifications have been received by both parties, the Agreement will enter into force on the following day. In Taiwan, the ECFA must pass through the Legislative Yuan. The Legislative Yuan reviewed and passed the ECFA and related bills on 17 August 2010. Taiwan's Straits Exchange Foundation and the Mainland's Association for Relations Across the Taiwan Strait will both complete written notifications to make an early entry into force of the Agreement.

The Early Harvest List for Trade in Goods shall be effective within six months after the date when ECFA comes into force. Should the ECFA be ratified within the second half of 2010, it is anticipated that the Trade in Goods List could become effective from 1 January 2011. The Early Harvest List for Trade in Services is also expected to become effective soon after the ECFA enters into force.

## Major Provisions in the ECFA

### Annual Tariff Reduction Schedule

The Early Harvest List for Trade in Goods includes commitments to reduce customs duties on a number of products in a three-year period:

- i. Products imported into Mainland China from Taiwan - agricultural/fishery products, petrochemical products, machinery, textiles and apparels, transport apparatus, steel, cement, dyes and pigments, sporting equipment, medical devices, molds, iron, metal products, glass, rubber, electronics and household appliances.

The following Table shows the tariff reduction schedule for Mainland China for the Early Harvest products above:

2009 China Import Duty rates (X%) <sup>1</sup>	Tariff Reduction Period			General Categories Covered <sup>2</sup>
	Year 1 (Estimated at 01 January, 2011)	Year 2 (Estimated at 01 January, 2012)	Year 3 (Estimated at 01 January, 2013)	
0<X≤5	0%	0%	0%	Machinery for Producing Plastic, various items of Petrochemicals, Textiles and Apparel , and Metal Products
5<X≤15	5%	0%	0%	Applicable mostly to: Agricultural/Fishery Products, Cement, Petrochemicals, Plastic/Rubber, Textiles and Apparel, Footwear, Household Appliances, Tools and Machinery, Electronics, Automotive Parts and Automotives.
X>15	10%	5%	0%	Suitcases, Irons and Under Garments

- ii. Products imported into Taiwan from Mainland China - petrochemicals , machinery, textiles and apparels, transport apparatus, chemicals, dyes and pigments, sporting equipment, instruments, molds, metal products, glass, rubber and electronics.

The following Table shows the tariff reduction schedule for Taiwan for the Early Harvest products above:

2009 Taiwan Import Duty rates (X%) <sup>3</sup>	Tariff Reduction Period			General Categories Covered
	Year 1 (Estimated at 01 January, 2011)	Year 1 (Estimated at 01 January, 2012)	Year 1 (Estimated at 01 January, 2013)	
0<X≤2.5	0%	0%	0%	Various items of Petrochemicals, Machinery and Electronics etc
2.5<X≤7.5	2.5%	0%	0%	Applicable mostly to: Raw Materials of Plastic, Textile and Apparel , Machinery, Electronics, Bicycles and Automotive Parts
X>7.5	5%	2.5%	0%	Rubber Tires, Textiles and Products of Silk

[1] 2009 China Import Duty rates (x%) refer to the 2009 non temporary import duty rates applicable to the member countries of WTO.

[2] Detailed listing of the goods covered is in the Annex 1 of the ECFA.



In addition to the Early Harvest List, negotiations for tariff reduction on other products shall be initiated within 6 months from the date when ECFA became effective.

The Provisional Rules of Origin takes into consideration the different manufacturing and assembly processes to assign an origin criteria for each product such as, change in tariff classification, value add content, minimum processing activities, etc.

At present, Taiwan enforces import prohibitions on over 2,000 products from Mainland China. In addition, there are approximately 500 products subject to conditional imports<sup>4</sup>. The current restrictions imposed by Taiwan on imported products from China have not been lifted upon signing of the ECFA. Although Taiwan is offering only 267 products under its Early Harvest List, it does show some level of commitment to the development of its preferential treatment to mainland China.

Source of information: Taiwan Bureau of Foreign Trade announcement [Consolidated List of Conditional Import Items of Mainland China Origin] and [Consolidated List of Prohibited Import Items of Mainland China Origin].

### Relaxation of restrictions on trade in services

Early Harvest List for Trade in Services includes the following:

	Early Harvest List by Mainland China	Early Harvest List by Taiwan
<b>Non-Financial Services</b>	<ul style="list-style-type: none"> <li>▶ Accounting, Auditing and Bookkeeping Services (Extension of Temporary Audit License period)</li> <li>▶ IT Services</li> <li>▶ Natural Science and Engineering research and development</li> <li>▶ Conference Services</li> <li>▶ Professional Designing</li> <li>▶ Removal of Quota for Taiwanese made Films</li> <li>▶ Hospital Supplies</li> <li>▶ Aircraft Maintenance</li> </ul>	<ul style="list-style-type: none"> <li>▶ Research and Development</li> <li>▶ Conference Services</li> <li>▶ Jointly operated Trade Shows</li> <li>▶ Specialty Product Designing (Other than Interior Designing)</li> <li>▶ 10 Film Screening of China made and Chinese Taiwan made Films per Year</li> <li>▶ Brokerage firms (other than movable property)</li> <li>▶ Sports and Leisure</li> <li>▶ Air Transport Service Industry Computer Booking Systems</li> </ul>
<b>Financial Services</b>	<ul style="list-style-type: none"> <li>▶ Banking</li> <li>▶ Securities and Stock</li> <li>▶ Insurance</li> </ul>	<ul style="list-style-type: none"> <li>▶ Banking</li> </ul>

[3] 2009 Taiwan Import Duty rates (x%) refer to the 2009 non temporary import duty rates applicable to the member countries of WTO

[4] Source of information: Taiwan Bureau of Foreign Trade announcement [Consolidated List of Conditional Import Items of Mainland China Origin] and [Consolidated List of Prohibited Import Items of Mainland China Origin].

In addition to the Early Harvest List, further relaxation shall be provided on Trade in Services by having next round of negotiations within six months on entry into force.

## Investment

The Agreement provides for establishment of safeguards, enhanced transparency and convenience for investments made within six months of its entry into force. In Taiwan, investment from Mainland is restricted to industries set forth in the List above.

## Economic cooperation

The parties reached a consensus to strengthen economic cooperation, including intellectual property protection, finance, manufacturing, trade facilitation and expedition, Customs collaboration and establishment of trade facilitation Offices within each Party.

## General observations

China's Early Harvest List in the Agreement provides preferential treatment for 539 items (in addition to the 15 items of fruit products offered to Taiwan on 1 August 2010). Taiwan's List covers 267 items. If the ECFA enters into force by 1 January 2011, it is anticipated that these goods will become duty free by 2013. Qualifying goods traded between Mainland China and Taiwan must satisfy the Provisional Rules of Origin in order for products to qualify for preferential duty treatment. Manufacturers and suppliers from both sides should review and understand those Rules to ensure their goods meet the origin requirements in order to enjoy this preferential treatment and cost saving opportunity.

Traditionally, investment in Mainland from Taiwan has mainly been in the manufacturing sector to produce goods for export markets. An entity is usually set up under a processing trade arrangement to benefit from lower labor costs and overhead costs in China. However, as mainland's business environment is rapidly changing and with the increase in domestic demand and higher labor and overhead costs in mainland, investors from Taiwan should adjust their business strategies to adapt to the changing market dynamics and enjoy the benefits from the ECFA.

It is anticipated that the cost of importing goods into mainland from Taiwan will be lowered with the Early Harvest List for Trade in Goods and increase market share for products from Taiwan. For example, high-quality bicycles imported into Mainland attract a 13% customs duty. When the ECFA is implemented, imports of this product from Taiwan will be more competitive. Furthermore, the ECFA will also benefit Taiwan owned entities using raw materials from Taiwan and producing in Mainland for the domestic market. Taiwan companies should assess the most appropriate mode of importation, entity setup and manufacturing arrangement when deciding their entry strategy into Mainland.

In the Early Harvest List for Trade in Services, the opening up of this sector has reduced thresholds that may also shift Taiwan's investments into Mainland away from traditionally manufacturing-oriented businesses.

Implementation of the ECFA is anticipated to lead to an increase in investments from the Mainland into Taiwan, tourism, conferences, trade shows and brokerage firms and agency sectors which will help increase Taiwan's economic activities and also increase employment opportunities.

## Conclusion

The ECFA is a broad framework agreement covering tariff reductions, opening up of service sectors, investment promotion and safeguards, intellectual property protection and broader scope for economic cooperation. Following signing of the ECFA, the next step involves discussions on both sides to finalize of the goals set in the ECFA. The ECFA between Mainland China and Taiwan is expected to have significant benefits for companies that evaluate the impact to their industry/products and develop strategies to take advantage of the preferential treatment afforded.

For further information, please contact Ernst & Young's Indirect Tax Team in China:

**Shanghai**  
**Robert Smith, Partner**  
+86 21 2228 2328  
[robert.smith@cn.ey.com](mailto:robert.smith@cn.ey.com)

**Bryan Tang, Director**  
+86 21 2228 2294  
[bryan.tang@cn.ey.com](mailto:bryan.tang@cn.ey.com)

**Hong Kong**  
**William Chea, Director**  
+852 26293440  
[william.chea@hk.ey.com](mailto:william.chea@hk.ey.com)

**Beijing**  
**Kenneth Leung**  
+86 10 5815 3803  
[kenneth.leung@cn.ey.com](mailto:kenneth.leung@cn.ey.com)

Ernst & Young

Assurance | Tax | Transactions | Advisory

### About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 144,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com)

### About Ernst & Young's Tax Services in China

Ernst & Young's 930 tax professionals in China provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. Our talented people, consistent methodologies and unwavering commitment to quality service help you to build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its ambitions. It's how Ernst & Young makes a difference.

[www.ey.com/china](http://www.ey.com/china)

© 2010 Ernst & Young (China) Advisory Limited.  
All Rights Reserved.

FEA no. 03000618

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither Ernst & Young (China) Advisory Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.