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Newsletter edited by the Asquance Team in China

Chinese VAT: avoid risks and earn up to 13% more margin

Hello,

Beware of Ex Works China imports

Ex Works transactions oblige the buyer to clear customs in China. China VAT rules complicate clearance.

A correct VAT invoice is necessary to clear customs. The Chinese official invoice is edited on pre-printed paper purchased from the local tax office. Since emitting a credit memo after the month of invoice issue requires tax office approval, getting it right first time is critical. Avoiding fake invoice paper is also important, as it could result in serious problems at customs.

Finally, importing and exporting require a license. Companies that do not have a license must proceed through an agent such as government controlled Cosco, who will handle permits, declarations and payments.

In short select an Incoterm such as FOB that tasks the supplier with China customs clearance.

Chinese VAT: instrument of industrial policy

VAT in China is a key instrument of industrial policy. The state intervenes frequently to refine or change the scope of VAT.

When the economy was overheating in 2006-2007, the government tried to steer away from process manufacturing and basic industries. It used VAT and free trade zone policy changes to drive companies further up the food chain.

Times have changed. A number of the 2006 changes have been reversed. Moving further up the food chain is encouraged by extra VAT refunds and some local demand props.

Chinese VAT is different

The most significant differences are:

- Company VAT status depends on size: small companies pay a simplified non deductible version.
- Slightly different scope for services: maintenance / repair are differentiated and subject to different rates
- Deductibility rules: only purchases linked to company main activity are refundable (ie, traded goods and since 2009 related fixed asset investments), not always 100%. It is important for Chinese entrepreneurs to define the "right" business scope when setting up.
- Export treatment: VAT is refunded. This is a key state policy driver

Process trade manufacturing

A lot of China imports are destined for re-export, in which case the factory can operate under a process manufacturing license, and maintain records of imports, bills of materials and exports. Under such arrangements imports are VAT free and a log kept. A tally of component usage in products for final re-export is kept and tightly controlled by customs. Locally sourced materials are subject to VAT. Deductibility is possible within the rules set above.

Note that process manufacturing factories cannot operate for local China production. At least a separate business license is required, and in practice it is recommended by local tax offices that the two companies operate in separate premises with separate warehouses.

Selling to China (from abroad)

When selling to China, you will be subject to import VAT at 17%. Local competitors will be subject to VAT on purchases inside China at varying rates, most likely from a lower cost base. They will also have a choice in how much VAT they charge on sales, depending on (tweakable by maintaining good relations with the tax office) goods and sales classification.

Buying from China (from abroad)

When buying from China some form of VAT deductibility is possible for the exporter. Check product harmonized customs code. Also spend time to evaluate deductibility on supplier purchases. These seem trivial but if your contractor is not totally forthcoming with this information they can walk with 13% of your buy price. A 13% cost decrease is nice to have any time.

Mountains are high and the emperor is far away

VAT is collected and organized at central government level. Rule interpretation and enforcement is at the local level, sometimes leading to tweaking (seen by local officials as "discounts" on "their area" of tax revenue). Remember that Chinese provincial government officials are paid on GDP growth and that a Chinese province can have a population of 100 million. This gives scope for local interpretation and "negotiation".

To illustrate how much scope provincial officials have in China: The central government decreed the end of free trade zones in China in 2008. Officials from the main Shanghai Free Trade Zone (WaiGaoQiao, in Pudong) were then seen offering 'discounts' to their 'loyal customers' to retain business inside the free trade zone and negate the effect of those pesky central government meddlers.

VAT is a work in process. China is a work in progress. Over 300 changes were brought to VAT law at all levels since 2005. It is not over.

For example, the Ministry of Finance announced late December 2008 that China would resume charging the 17% VAT rate on metallic and non-metallic mineral products, up from 13 percent, as of January 1, 2009. However in the face of collapsing demand, this measure may be scrapped by the end of march 2009.

VAT rates

- Basic rate varying from 4-6%, since January 1st 2009 unified at 5%
- Normal rate of 17%

Fixed assets and R&D treatment

Until January 2009, fixed asset investment was non-deductible. It now is, subject to conditions and scales depending on asset types, to drive local R&D investment.

VAT refunds

Export VAT refunds are subject to application as part of monthly declaration. Deduction rates are set by customs codes category. Some products have no deductibility. Deductible rates are 5%, 9%, 11%, 13%, 14%, 17%. Classification can have a major impact.

January 2009 changes

Rises in tax rebate rates varied among different items. For example, the rate on tires was raised from 5 to 9% while glassware was up 5 to 11%. Rates on labor-intensive products such as luggage, shoes and umbrellas were elevated from 11 to 13%.

The 3,770 items modified in January accounted for 27.9% of China's exports, according to a government statement at the time.

The statement said the government would also eliminate export duties on certain types of steel, chemical and grain products and reduce export duties on some fertilizer products.

See example table on page 4

Other taxes

The PRC levies import duties. Some non renewable natural resources are also subject to export duty (eg: oil, gas, minerals).

Dangerous, polluting or luxury products are also subject to an additional consumption tax, reserved for consumption inside China. You will most likely not encounter it.

Action plan:

- Check your Incoterm and negotiate to reduce your exposure.
- Always have a contract
- Check the customs codes used by your Chinese partners. Given frequent rules changes, optimization may be possible. You can make this a win-win situation
- Ensure that you get the benefit of VAT refunds not only on exports, but also on supplier purchases
- Do not forget the above when negotiating initially with suppliers. Your best chance to secure a good deal is during this negotiation phase.
- Contact Asquance to find out how to optimize your buy costs, quality and procurement in Asia.

Best regards,
Thuy Marchal, President

Who we are:

Asquance was created by European, American and Asian managers to help growing companies optimise their sourcing, quality and procurement.

From its bases across China, France, Vietnam and India the Asquance team employs robust collaborative tools to optimise client supply chain and product development.

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Example Table: New VAT refund rates for some exported wood products and exported furniture

Products	Tariff Codes	Adjusted VAT refund Rates (%)
Particle board, fiberboard of wood, & similar board of wood etc	4410110000-4411942900	9
Plywood, veneer etc.	4412101199; 4412101919, 4412102099, 4412109190, 4412109290, 4412310090, 4412321090, 4412329090, 4412390090, 4412941090, 4412949190, 4412949290, 4412949990, 4412991090, 4412999190, 4412999290, 4412999990-4413000000	9
Windows, French Windows and their frames of wood.	4418100090	9
Doors and their Frames and thresholds of wood	4418200090-4418500000	9
Furniture	9403300090, 9403400090, 9403509990, 9403501090 - 9403509100, 9403609990 - 9403891000, 9403899000 – 9404210090	13