



Uplifting of Export VAT Refund Rates

Recently, the growth of China's export has shown signs of slowing down. Profits of export-orientated businesses in China have decreased sharply due to the shrinking demand from international markets, Renminbi appreciation, and increase in raw materials and labor costs. Many export businesses that are of labor-intensive nature are now facing heavy pressure and risk of closure (in particular small-medium sized manufacturing/ processing businesses in the Pearl River Delta region in Southern China).

It has been reported that the Chinese authorities are formulating a series of foreign trade adjustment policies to help the weakening export trend, and one of the adjustments is the uplifting of the export VAT refund rates.

Current Round of Changes in Export VAT Refund Rates

On 21 October 2008, the Ministry of Finance ("MOF") and State Administration of Taxation ("SAT") jointly issued Cai Shui [2008] No.138 ("Circular 138") which introduces uplifting of the export VAT refund rates for selected commodities with effect from 1 November 2008.

In total 3,486 categories of selected commodities are included in the current round of adjustment. This represents 25.8% of all the commodities listed on the Chinese Harmonized System. The selected commodities mainly cover those of labor-intensive and high-tech / high-value added nature, including (but not exclusive to) : textile, garments, toys, furniture and anti-AIDS drugs.

After this round of changes, the Chinese export VAT refund rates would be classified into 6 categories: 5%, 9%, 11%, 13%, 14% and 17%. The current Chinese VAT regime entitles exporters of tangible goods to export VAT refund. The amounts of VAT refund vary partly depending on the export VAT refund rates applicable to specified types of export goods. The input VAT could be refunded fully, partially or no refund at all.

The uplifting of the export VAT refund rates will reduce the irrecoverable VAT costs of export of the selected commodities, and thus the greater amount of refund will be available. This should not only promote the competitiveness of those labor-intensive export businesses (hence stabilize the labor market), but also facilitate an accelerated growth of the businesses exporting high-tech / high-value added commodities. Undoubtedly such change should be welcome by exporters in these businesses.

PwC Observation

The Chinese government has employed a number of policy tools to steer the direction of the economic growth. Apparently, one recently favored tool is export VAT refund policy coupled with adjustments in the export VAT refund rates.

In addition to the changes brought by Circular 138, the MOF and SAT have also jointly issued Cai Shui [2008] No.111 ("Circular 111") on 30 July 2008 which raised the export VAT refund rates of certain textile and bamboo-made products. However, the export VAT refund of selected commodities, such as certain silver and battery products have been cancelled by virtue of Circular 111.

The frequency and scale of the adjustments on export VAT refund rates introduced in the past few months could be perceived as the Chinese government's response to the rapid changes to the world's economic climate. Moreover, the direction of the rate adjustments has changed from reduction in 2007 to uplifting in

2008, and it is likely that the uplifting direction would continue for certain period in future unless the foreign trade shows positive trend again. Another remarkable change in the current round of adjustment is that the export VAT refund rate of certain commodities could be adjusted as far and as frequent as the Chinese government thinks necessary. For example, the export VAT refund rate of certain textile products, such as silk yarn, was changed to 13% by Circular 111. The export VAT refund rate of these commodities is increased again by Circular 138 to the 14% category.

It is very obvious now that China has used export VAT refund policy as an important fiscal tool to regulate her export economy.

These frequent and unpredictable adjustments to the export VAT refund rate structure may affect businesses' supply chains and pricing models as well as strategic plan. For instance, for businesses which have adopted "bonded zone" arrangements to mitigate the irrecoverable VAT costs due on exports, the increase to the export VAT refund may reduce the cost-benefit of the arrangements adopted. In this respect, business should review their supply chain strategies and cost structure on a timely and regular fashion with a view to determine whether their current business model in/with China would still be commercially viable in light of the changes.

China may introduce more measures to sustain its economic growth and to help struggling businesses to withstand the current global financial crisis, one of which could be the expansion of the scope of input VAT recovery on investments in capital goods (please refer to our China Tax and Business Newsflash Issue 8, September 2008 for details). Business should stay tune with these changes, understand their impact and make plans to explore arrangements which may help facing the challenges.

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