

Tax

Issue P252/2016 – 22 November 2016

Tax Analysis

Update on Export Tax Refunds: Revised Guidance on Administrative Classification of Export Enterprises

Authors:

Beijing

Yi Zhou

Partner

Tel: +86 10 8520 7512

Email: jchow@deloitte.com.cn

Charles Gong

Partner

Tel: +86 10 8520 7527

Email: charlesgong@deloitte.com.cn

Alex Duan

Senior Manager

Tel: +86 10 8512 4011

Email: alduan@deloitte.com.cn

In July 2016, China's State Administration of Taxation (SAT) issued revised *Measures for Classification of Enterprises Eligible for Export Tax Refund (Exemption)* (SAT Bulletin [2016] No. 46, or "Bulletin 46") which apply as from 1 September 2016. Bulletin 46, together with supplementary guidance provided in Bulletin 61,¹ constitutes the framework for the current assessment classification of export enterprises and reflects some changes to the classification assessment criteria and related measures that should make it easier to qualify for favorable treatment and expedite the export tax refund (exemption) process.² Aside from the fact that China's "social credit" system is becoming increasingly important, provisions relating to the classification of export enterprises should be taken into account by enterprises carrying out exports.

Background

In response to the Chinese government's goals to establish a sound social credit system, optimize export tax refund services and ensure compliance with the export tax refund regulations, the SAT began implementing a system for classifying enterprises that are eligible for export tax refunds as from 1 March 2015. This system categorizes export enterprises as Classes 1 to 4, and the tax

¹ *Bulletin on Further Optimizing the Administration of Tax Refund (Exemptions) on Exported Goods for Foreign Trade Service Enterprises* (SAT Bulletin [2016] No. 61), which became effective on 1 October 2016.

² For purposes of this article, export tax refunds (exemptions) collectively are referred to as "export tax refunds."

authorities use different factors for the categorization and offer various services for each class. Class 1 and Class 2 enterprises enjoy simplified administrative procedures and priority in filing for export tax refunds and, therefore, may achieve a better cash flow than enterprises falling in Class 3 or 4.

The revised measures in the new bulletins generally lower the standards for enterprises to be treated as Class 1 enterprises; hence, more enterprises may enjoy the preferential treatment available for Class 1 enterprises. The revised measures also provide separate sets of assessment criteria for Class 1 enterprises that are foreign trade enterprises and foreign trade service enterprises; previously, the same set of criteria applied to all enterprises.

Assessment criteria

In accordance with the revised classification measures, an enterprise still may be categorized as a Class 1 to 4 enterprise for purposes of administering VAT export refunds. The major factors that are taken into account in determining the classification of an enterprise include the following:

- Whether the export enterprise has the appropriate production capacity (applicable only to a manufacturing enterprise);
- Whether the export enterprise has been involved in the issuance of false VAT special invoices³ or other violations of the export tax refund regulations;
- Whether the export enterprise has established a comprehensive internal control system for export tax refunds;
- Whether the net assets of the export enterprise reach a certain threshold; and
- Whether the export enterprise has committed other acts involving seriously dishonest behavior.

The assessment criteria to qualify as a Class 1 enterprise under the revised measures depends on the type of the export enterprise, namely, whether it is a manufacturing enterprise, a foreign trade enterprise or a foreign trade service enterprise. Because they have no production capacity or manufacturing sites and possibly no warehouses or inventory in China, foreign trade enterprises and foreign trade service enterprises generally are perceived as enterprises with a higher export tax refund compliance risk from a regulatory perspective. Accordingly, the Class 1 assessment criteria for such enterprises is more stringent than the criteria for manufacturing enterprises.

It is important to note that compliance rating of an export enterprise for general tax, customs and foreign exchange purposes also will be considered in determining its classification for export VAT refund (exemption) purposes, as shown in the following table:

For more information, please contact:

Asia Pacific Indirect Tax & Customs Services Leader Hong Kong

Sarah Chin
Partner
Tel: +852 2852 6440
Email: sachin@deloitte.com.hk

Asia Pacific Customs & Global Trade Centre of Excellence Leader Hong Kong

William Marshall
Partner
Tel: +852 2852 5668
Email: wmarshall@deloitte.com.hk

Northern China Beijing

Yi Zhou
Partner
Tel: +86 10 8520 7512
Email: jchow@deloitte.com.cn

Eastern China Shanghai

Liquan Gao
Partner
Tel: +86 21 6141 1053
Email: ligao@deloitte.com.cn

Southern China Guangzhou

Janet Zhang
Partner
Tel: +86 20 2831 1212
Email: jazhang@deloitte.com.cn

Western China Chongqing

Frank Tang
Partner
Tel: +86 23 8823 1208
Email: ftang@deloitte.com.cn

³ The issuance of false invoices may be interpreted broadly, to include a situation where the information included in an invoice was inconsistent with the actual facts (e.g. an invoice was issued for a fake transaction).

Classification of the export enterprise	General tax compliance rating	Customs compliance rating	Foreign exchange compliance rating
Class 1	A or B	Certified enterprise* or general enterprise	A* or B
Class 2			
Class 3	C (or not assessed yet)		
Class 4	D	Dishonest enterprise	C

*To qualify as a Class 1 enterprise, a foreign trade enterprise or foreign trade service enterprise must be a customs certified enterprise and obtain an "A" rating for foreign exchange compliance.

Administrative measures

Under Bulletins 46 and 61, the SAT has adopted administration measures for export enterprises that vary depending on how the entity is classified. The main measures include the following:

- "Green channels" (special service areas) are introduced for Class 1 enterprises, which are given priority in claiming export tax refunds, and a key contact system is established to expeditiously resolve issues relating to export tax refunds for such enterprises.
- Class 1 enterprises that also have an "A" rating for general tax compliance purposes may enjoy other measures that facilitate the administration in respect of finance, social security, etc., according to general guidance jointly issued by the Ministry of Finance, the SAT and other government departments.
- For qualified Class 1 enterprises that claim an export tax refund, the process can be accelerated and completed within five business days.
- For Class 2 and Class 3 enterprises, the export tax refund formalities can be completed within 10 and 15 business days, respectively.
- For Class 4 enterprises, there is generally no deadline to finalize the export tax refund process. The tax authorities are required to conduct rigorous examinations of such enterprises.
 - § For Class 4 manufacturers' exports of goods, the tax authorities are required to evaluate the manufacturer's production capacity and tax payment status; if the goods were purchased from external parties but are deemed to be self-made,⁴ the tax authorities will inspect a certain percentage of the goods.
 - § For Class 4 foreign trade service enterprises, the tax authorities are generally required to inspect a certain percentage of the exported goods by sending a confirmation letter to relevant parties, and the refund formalities must be completed within 20 business days after accepting the enterprises' export tax refund filings.

Comments

The tax authorities regard the examination involved in granting an export tax refund as a key responsibility in combatting illegal means of generating fraudulent export tax refunds for goods or services (such as the use of false VAT special invoices, false claims and the purchase of documents for customs declarations), and they usually conduct inspections involving a production capacity assessment and investigations into the invoices for exported goods. If the authorities discover export tax refund irregularities (e.g. receipt of false VAT special invoices due to inadequate internal controls) during an examination that were ignored by the enterprise, the authorities may disqualify the enterprise from the export tax refund; sometimes, the tax authorities may delay the export tax refund process to rule out any uncertainties, even if no specific noncompliance has been identified. In extreme cases, the export tax refund may be suspended for a long period of time that seriously hinders the regular operations of an enterprise.

As noted above, the SAT began implementing the classification system for export enterprises in March 2015, which represented a change in the tax authorities' administration process, under which enterprises with higher compliance ratings may accelerate the tax refund process and improve their cash flow, and the tax authorities also can reduce the related administrative burden. The revised

⁴ For a manufacturer's exports of goods that were purchased from external parties, a VAT refund generally will not be granted on such goods unless the goods are deemed to be self-made products by the manufacturer.

measures lower the standards to qualify as a Class 1 enterprise (for instance, the revised measures removed the requirement of "no violations in the export tax refund regulations" and instead changed it to "no involvement in issuance of false special VAT invoices or other violations of the export tax refund regulations for the recent three years") and shorten the duration for completing export tax refund formalities in general, which should be more favorable to enterprises with good compliance records. Export enterprises should consider applying for certification as a Class 1 enterprise to accelerate the tax refund progress and improve operating efficiency. However, enterprises planning to apply for Class 1 certification should focus on the following actions:

- **Establish a sound internal control system concerning export tax refunds:**

A comprehensive internal risk control system for export tax refunds can reduce the incidence of receiving false VAT special invoices in good faith during the procurement process, which can enhance the enterprise's compliance in relation to export tax refunds. A sound internal control system also is required in the assessment criteria for a Class 1 enterprise.

Because of its particular characteristics, an export tax refund has different requirements from other general tax-related matters. A comprehensive internal control system must ensure accurate computing of the tax refund amount, to avoid not only potential risks of a tax law violation due to excessive tax refund claims, but also potential losses caused by an undervalued tax refund. Therefore, export enterprises must place great importance on the establishment of an internal control system for export tax refunds and, if necessary, should seek professional advice.

- **Maintain high ratings for general tax compliance and foreign exchange administration, and timely apply for customs authorized economic operator (AEO) certification:**

As mentioned above, the compliance ratings for general tax, customs and foreign exchange administration purposes are significant factors in the assessment criteria for Class 1 enterprises. Therefore, export enterprises planning to apply for Class 1 certification must ensure they have good compliance records involving foreign exchange, customs and other tax-related matters.

It is important to note that foreign exchange receipts and payments, as well as import and export declarations for goods, are closely linked to export tax refunds. Export enterprises should coordinate the compliance management of foreign exchange, customs and export VAT refunds, to improve the enterprise's rating for all types of classified administration and facilitate beneficial interactions among the three areas.

In the meantime, considering that the customs authorities actively are promoting AEO certification and that to achieve Class 1 status foreign trade enterprises and foreign trade service enterprises must be certified by customs (i.e. they must be a type of China customs-certified enterprise, such as an advanced certified enterprise or a general certified enterprise), export enterprises planning to apply for Class 1 certification should actively prepare for AEO certification.

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

Beijing

Andrew Zhu
Partner
Tel: +86 10 8520 7508
Fax: +86 10 8518 1326
Email: andzhu@deloitte.com.cn

Chengdu

Frank Tang / Tony Zhang
Partner
Tel: +86 28 6789 8188
Fax: +86 28 6500 5161
Email: ftang@deloitte.com.cn
tonzhang@deloitte.com.cn

Chongqing

Frank Tang / Tony Zhang
Partner
Tel: +86 23 8823 1208 / 1216
Fax: +86 23 8859 9188
Email: ftang@deloitte.com.cn
tonzhang@deloitte.com.cn

Dalian

Bill Bai
Partner
Tel: +86 411 8371 2816
Fax: +86 411 8360 3297
Email: billbai@deloitte.com.cn

Guangzhou

Victor Li
Partner
Tel: +86 20 8396 9228
Fax: +86 20 3888 0121
Email: vicli@deloitte.com.cn

Hangzhou

Qiang Lu / Fei He
Partner / Director
Tel: +86 571 2811 1901
Fax: +86 571 2811 1904
Email: qilu@deloitte.com.cn
fhe@deloitte.com.cn

About the Deloitte China National Tax Technical Centre

The Deloitte China National Tax Technical Centre ("NTC") was established in 2006 to continuously improve the quality of Deloitte China's tax services, to better serve the clients, and to help Deloitte China's tax team excel. The Deloitte China NTC prepares and publishes "Tax Analysis", "Tax News", etc. These publications include introduction and commentaries on newly issued tax legislations, regulations and circulars from technical perspectives. The Deloitte China NTC also conducts research studies and analysis and provides professional opinions on ambiguous and complex issues. For more information, please contact:

National Tax Technical Centre

Email: ntc@deloitte.com.cn

National Leader

Ryan Chang
Partner
Tel: +852 2852 6768
Fax: +852 2851 8005
Email: ryanchang@deloitte.com

Southern China (Hong Kong)

Davy Yun
Partner
Tel: +852 2852 6538
Fax: +852 2520 6205
Email: dyun@deloitte.com.hk

Harbin

Jihou Xu
Partner
Tel: +86 451 8586 0060
Fax: +86 451 8586 0056
Email: jihxu@deloitte.com.cn

Hong Kong

Sarah Chin
Partner
Tel: +852 2852 6440
Fax: +852 2520 6205
Email: sachin@deloitte.com.hk

Jinan

Beth Jiang
Partner
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068
Email: betjiang@deloitte.com.cn

Macau

Raymond Tang
Partner
Tel: +853 2871 2998
Fax: +853 2871 3033
Email: raytang@deloitte.com.hk

Nanjing

Frank Xu / Rosemary Hu
Partner
Tel: +86 25 5791 5208 / 6129
Fax: +86 25 8691 8776
Email: frakxu@deloitte.com.cn
roshu@deloitte.com.cn

Shanghai

Eunice Kuo
Partner
Tel: +86 21 6141 1308
Fax: +86 21 6335 0003
Email: eunicekuo@deloitte.com.cn

Shenzhen

Victor Li
Partner
Tel: +86 755 3353 8113
Fax: +86 755 8246 3222
Email: vicli@deloitte.com.cn

Suzhou

Maria Liang / Kelly Guan
Partner
Tel: +86 512 6289 1328 / 1297
Fax: +86 512 6762 3338
Email: mliang@deloitte.com.cn
kguan@deloitte.com.cn

Tianjin

Jason Su
Partner
Tel: +86 22 2320 6680
Fax: +86 22 2320 6699
Email: jassu@deloitte.com.cn

Wuhan

Justin Zhu / Gary Zhong
Partner
Tel: +86 27 8526 6618
Fax: +86 27 6885 0745
Email: juszhu@deloitte.com.cn
gzhong@deloitte.com.cn

Xiamen

Jim Chung / Charles Wu
Partner / Director
Tel: +86 592 2107 298 / 055
Fax: +86 592 2107 259
Email: jichung@deloitte.com.cn
chwu@deloitte.com.cn

Northern China

Julie Zhang
Partner
Tel: +86 10 8520 7511
Fax: +86 10 8518 1326
Email: juliezhang@deloitte.com.cn

Southern China (Mainland/Macau)

German Cheung
Director
Tel: +86 20 2831 1369
Fax: +86 20 3888 0121
Email: gercheung@deloitte.com.cn

Eastern China

Kevin Zhu
Director
Tel: +86 21 6141 1262
Fax: +86 21 6335 0003
Email: kzhu@deloitte.com.cn

Western China

Tony Zhang
Partner
Tel: +86 23 8823 1216
Fax: +86 23 8859 9188
Email: tonzhang@deloitte.com.cn

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify Wandy Luk by either email at wanyluk@deloitte.com.hk or by fax to +852 2541 1911.

About Deloitte Global

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, consulting, financial advisory, risk management, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 225,000 professionals make an impact that matters, please connect with us on Facebook, LinkedIn, or Twitter.

About Deloitte in Greater China

We are one of the leading professional services providers with 24 offices in Beijing, Hong Kong, Shanghai, Taipei, Changsha, Chengdu, Chongqing, Dalian, Guangzhou, Hangzhou, Harbin, Hefei, Hsinchu, Jinan, Kaohsiung, Macau, Nanjing, Shenzhen, Suzhou, Taichung, Tainan, Tianjin, Wuhan and Xiamen in Greater China. We have nearly 13,500 people working on a collaborative basis to serve clients, subject to local applicable laws.

About Deloitte China

The Deloitte brand first came to China in 1917 when a Deloitte office was opened in Shanghai. Now the Deloitte China network of firms, backed by the global Deloitte network, deliver a full range of audit, tax, consulting and financial advisory services to local, multinational and growth enterprise clients in China. We have considerable experience in China and have been a significant contributor to the development of China's accounting standards, taxation system and local professional accountants. To learn more about how Deloitte makes an impact that matters in the China marketplace, please connect with our Deloitte China social media platforms via www2.deloitte.com/cn/en/social-media.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is by means of this communication, rendering professional advice or services. None of the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.