

Sourcing from China

Export VAT Refund



One of the most frequently asked tax question is regarding the Export VAT Refund Scheme. The export VAT refund scheme applies if a Chinese company exports goods. When exporting goods, no VAT will be charged by the exporter. However, the export VAT refund impacts the recovery of VAT incurred on goods in 2 ways:

- Exporter is able to recover part of their VAT incurred on goods exported as a refund ("Cash Refund"); but
- Any VAT which cannot be recovered will be a cost to the exporter ("Restriction of the input VAT amount").

The refund is based on the export VAT refund rate of the exported goods which is determined by the Customs commodity code. The export VAT refund rates are between 0 percent and 17 percent. Where the refund rate is at 17 percent, there is a full recovery of the input VAT.

Cash refund

In China, the recovery of VAT incurred on costs is carried out by offsetting the input VAT against output VAT. For exports, where no VAT is charged, the exporter may be allowed to recover part of the input VAT as cash through the monthly export VAT refund claim.

The export VAT refund scheme is adding a cost for many businesses exporting. In practice, the non-recoverable VAT is passed on along the supply chain. To understand the pricing impact, the export VAT refund scheme needs to be fully understood.

Restriction of the input VAT amount

The amount of non-recoverable input VAT is determined by a number of factors but mostly by the export VAT refund rate of the exported goods and whether the company is a trading or manufacturing company.

The calculation of the export VAT refund is a complicated one but, to illustrate, when Chinese exporters incur VAT on costs (raw materials, overheads, machinery), they would typically pay 17 percent VAT on costs. If the VAT refund rate of the goods exported is less than 17 percent, such as 13 percent, the exporter is left with a 4 percent cost. This percentage of cost then applied either on the:

- Sales price of the exported goods (FOB price) for manufacturers; or
- Purchase price of the goods exported for trading companies.

The calculated irrecoverable amount is then deducted from the total input VAT incurred via the monthly VAT return. As there are limited goods carrying a full refund rate of 17 percent, the export VAT refund scheme creates a resulting cost for many businesses in China exporting.

Challenges in managing the export VAT refund

I. Frequent changes

China's export refund policy changes frequently. We have seen constant decreases of the export VAT refund rates for goods that consume precious and rare resources, pollutants, and trade disputes with China's trading partners. A decrease of export VAT refund rates leads to higher costs for the exporter. However, in time of economic crises, the rates have been increased to support the export sector. Therefore, it is important for exporters and also the foreign buyers to anticipate and respond to the export refund policy adjustments as this influences pricing.

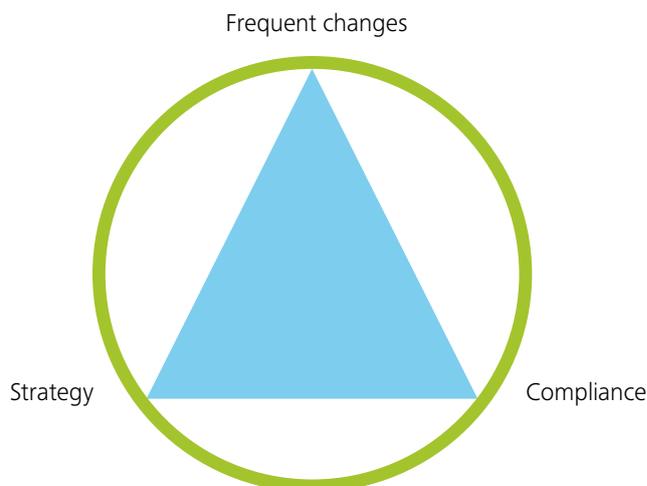
II. Compliance

When submitting the export VAT refund, export documents such as Export Declaration Form and Foreign Exchange Cancellation Form would be required. As the export documents are collected from different authorities and need to be provided within a specific timeframe, a process to manage and monitor the collection of export documents should be in place especially when a 3rd party export agent is involved. Any error with the filing of the export VAT refund claim, or incorrect supporting documentation, may result in a refusal of the refund and the export is deemed as a local supply plus VAT.

III. Strategy

From our experience, a strategy is needed and the below gives an overview of how to mitigate the potential impact on the export VAT refund scheme.

Challenges in managing the export VAT refund



Tariff coding	Reviewing the Customs classification of the goods to leverage off the most applicable commodity code and also the export VAT refund rate.
Supply chain model	The tax efficiency of the current export business model should be evaluated, to understand the tax costs and savings of other models such as examining the difference between contract manufacturing versus toll manufacturing.
Functions and risks	The functions and risks undertaken by the operation should be revisited to see if some functions could be performed and risks assumed outside China in order to lower FOB prices as this is one of the variables of the VAT refund calculation.
Increase of bonded imports	Increase of bonded imports will reduce the irrecoverable VAT cost, as bonded imports are excluded from the VAT cost calculation.
Communication	A good internal communication between different departments as sales, legal and finance/tax is needed.



Contacts

For more information, please contact:

Sarah Chin

Partner
Service Line Leader
Tel: +86 21 6141 1218
Email: sachin@deloitte.com.cn

Northern China

Andrew Zhu

Partner
Tel: +86 10 8520 7508
Email: andzhu@deloitte.com.cn

Eastern China

Li-Qun Gao

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

Southern China

Yi Zhou

Partner
Tel: +86 20 2831 1228
Email: jchow@deloitte.com.cn

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