

China alert

Tax and regulatory developments

TAX

November 2006, Issue 30

Export VAT: China's new tool for shaping economic development

In brief

- Export VAT refund rates have again been adjusted in response to a number of economic stimuli
- This issue of China alert introduces the rationale and the key products affected

Relevant regulations discussed in this issue:

Notice on Adjustment of Export VAT Refund Rates for Certain Products and Supplement to Prohibited Category for Processing Trade, Cai Shui [2006] No. 139, issued jointly on 14 September 2006 by the Ministry of Finance, National Development & Reform Commission, Ministry of Commerce, General Administration of Customs and State Administration of Taxation, effective from 15 September 2006 (Circular 139)

Supplementary Notice on Issues regarding Adjustment of Export VAT Refund Rate for Certain Products, Cai Shui [2006] No. 145, issued on 29 September 2006 by the Ministry of Finance, General Administration of Customs and State Administration of Taxation jointly, effective from 15 September 2006 (Circular 145)

Background

The China government has become aware of the following issues that have resulted from the country's rapid economic development:

- Products that are manufactured in China using pollution-inducing and high energy-consuming processes are mainly produced for export purposes, resulting in the outflow of scarce natural resources and damage to the local environment.
- High-volume exports of low value-added products from labour-intensive industries have triggered international trade friction and anti-dumping investigations.

In order to tackle these issues, five government departments jointly instigated a new round of adjustments on export VAT refund rates. These adjustments, promulgated in Circular 139 and Circular 145, attempt to use the export VAT refund mechanism as a tool to resolve such issues. These adjustments are applicable nationwide and affect, amongst others, Export Processing Zones, Free Trade Zones and other special areas under Customs supervision.

Key adjustments

- **Abolition of export VAT refunds for 258 types of product**, most of which are either mineral products, high-pollution products or products made from non-renewable natural resources (please refer to Table I).

Table I Products for which VAT refunds will be abolished

Key items	Previous refund rate (%)
Fine goat wool	5
Coal	8
Natural gas	11
Lead battery & mercury battery	13
Certain wooden products	13
Certain non-metal minerals (including pyrite, paraffin, stone stock, silicon, arsenic, etc.)	5, 11 & 13
Certain metals (including unwrought lead, copper, zinc, tin and their alloys, etc.)	5, 11 & 13

- **Reduction of export VAT refund rates** for products from industries which are considered to be “overheated” or labour-intensive such as steel, cement, and textiles (please refer to Table II).

Table II Products with reduced export VAT refund rates

Key items	Previous refund rate (%)	New refund rate (%)
Certain steel products	11	8
Ceramics & some finished leather products	13	8
Textile, furniture, plastic, cigarette lighters, and certain wooden products	13	11
Cements & glass	13	11
Certain non-ferrous metals	13	5, 8 & 11
Certain non-motorized vehicle and parts	17	13

- **Increase in VAT refund rates** for hi-tech and processed agricultural products (please refer to Table III). It is perceived that the government intends to promote technology-intensive industries and alleviate the potential effect of RMB appreciation on the agricultural industry through these changes.

Table III Products with VAT refund rate increased

Key items	Previous refund rate (%)	New refund rate (%)
Certain processed agricultural products	5 & 11	13
Large equipment, some IT products, biomedical products, and hi-tech products encouraged for export	13	17

Contact us

For more information on these new regulations and how they may affect your company, please contact:

Beijing/Qingdao

Khoonming Ho
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com.cn

Shanghai

John Lee
Tel. +86 (21) 6288 1819
john.lee@kpmg.com.cn

Hangzhou

Martin Ng
Tel. +86 (571) 2803 8081
martin.ng@kpmg.com.cn

Chengdu

David Ko
Tel. +86 (28) 8673 3888
david.ko@kpmg.com.cn

Guangzhou

Bolivia Cheung
Tel. +86 (20) 3758 9283
bolivia.cheung@kpmg.com.cn

Shenzhen

Christine Chung
Tel. +86 (755) 2547 1112
christine.chung@kpmg.com.cn

Hong Kong

Peter Kung
Tel. +852 2826 8080
peter.kung@kpmg.com.hk

• Grandfathering relief

Circular 139 took effect on 15 September 2006. Therefore, products declared to Customs on or after 15 September 2006 for export will be subject to the new VAT refund rates.

As has been the case with previous regulations, Circular 139 also provides a grandfathering provision by phasing in the new export VAT refund rates to certain exports over a fixed period. In this case, export enterprises can choose to enjoy the old VAT refund rate, provided that the following conditions are all satisfied:

- The export contract was signed on or before 14 September 2006
- The contract was filed with tax authority in charge of VAT refunds by 30 September 2006
- Goods will be declared for export on or before 14 December 2006.

For long-term coal export contracts with fixed prices, only the first two conditions need to be satisfied for the continued application of the old refund rate.

• New addition to prohibited category for processing trade

Circular 139 also states that products that are no longer applicable for VAT refunds will fall within the "prohibited" category for processing trade purposes. As such, the importation of such goods will be subject to import VAT and Customs duty.

By Khoonming Ho, Partner and Charles Gong, Manager

All issues of China alert are accessible on www.kpmg.com.cn and www.kpmg.com.hk

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2006 KPMG Huazhen, a Sino-foreign joint venture in the People's Republic of China and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.