

## The Latest Insight

### HOW TO CALCULATE VAT REBATES

[2nd June, 2009 Issues 8]

In our April tax newsletter, we discussed how China has increased VAT rebates six times since the second half of 2008. Our Firm has received some enquiries about the basis for calculation of VAT rebates. For completeness, we set out in this tax newsletter the salient points of general principle of VAT in China and the basis for calculating VAT rebates.

#### 1. General Principle of VAT

##### Definition

VAT is levied on all units and individuals engaged in the sale of goods, the provision of processing, repairs and replacement services within China, or the importation of goods into the territory of China.

##### Tax rates

There are two types of tax payers for VAT purpose: general taxpayers and small-scale taxpayers.

For general taxpayers, the VAT is levied at 17% on the turnover of the sales of goods and the provision of processing and maintenance services.

For small-scale taxpayers, with effect from 1 January 2009, VAT is levied at 3% on turnover derived.

With effect from 1 January 2009, the threshold for a general VAT payer is reduced from RMB1 million to RMB0.5 million for manufacturing taxpayers, and from RMB1.8 million to RMB0.8 million for commercial taxpayers.

VAT tax rates vary according to the taxable activities / classification. We would like to highlight the tax rates in the below table:

Taxable activity / classification	Tax rate
Sales of goods, processing, repair and replacement services, importation of goods	17% (basic rate)
Sales and imports of: <ol style="list-style-type: none"> <li>1. Food grains and edible vegetable oils;</li> <li>2. Tap water, heating, cooling, hot water, coal gas, liquefied coal / charcoal products for residential use;</li> <li>3. Books, newspaper and magazines;</li> <li>4. Feed, chemical fertilizers, agricultural chemicals, agricultural machinery and plastic film for agricultural purposes; and</li> <li>5. Other goods prescribed by State Council</li> </ol>	13% (reduced rate)
Small-scale taxpayers	3%

## Upcoming LB Events

### International Taxation: Minimising Expatriate Tax Obligations

8th June Shanghai

10th June Beijing

### Sustaining Development in the Economic Downturn

12th June Guangzhou

### Comparison between IFRS and Chinese GAAP

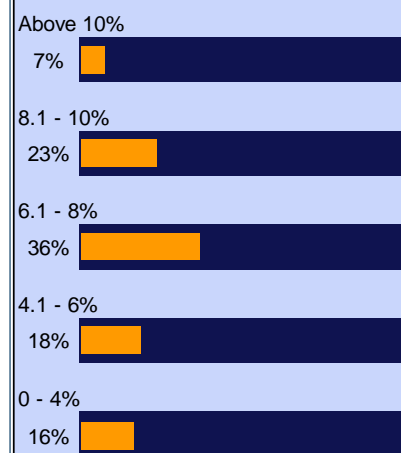
21st July 2009 Singapore,

22nd July 2009 Malaysia.

## Poll

The following results were registered in response to the question:

What do you expect China's growth to be in 2009?



Export goods	0%
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## Tax payable

### Tax payable formula for small-scale taxpayers

Tax payable formula for small-scale taxpayer is very simple. The input VAT is not deductible and any VAT paid on purchase would become the cost of good sold of small-scale taxpayers.

Tax payable = sales income x tax rate (3% with effect from 1 January 2009)

### Tax payable formula for general taxpayers

VAT payable = output VAT - input VAT

### Input VAT

Input VAT is the VAT paid or borne by taxpayers who purchase goods or receive taxable labor services. Normally, input VAT amount is stipulated in the VAT invoices when the general taxpayer buys goods from its domestic suppliers, or shown on the custom duty payment certificates when the taxpayer imports goods from overseas suppliers.

Under some circumstances, input VAT is not creditable. The circumstances include:

- Without obtaining valid supporting documents such as valid VAT invoices;
- The accounting systems and tax filings are very poor;
- Not being recognized as the general taxpayer, such as the small-scale taxpayer;
- The purchased goods / repair and processing services are for tax exemption items, such as manufacturing of exported goods;
- The purchased goods / repair and processing services are for collective welfare or individual consumption;
- Goods suffered abnormal losses.

### Output VAT

Output VAT is the VAT payable by taxpayers who sell goods or provide taxable labor services. Input and output taxes are calculated based on the value of the purchase and sales of the goods respectively.

The formula for output VAT is as follows:

Output VAT = turnover or taxable value x tax rate

The turnover includes all the amounts and additional charges (i.e. allowances, overdue payment interest, leasing fees for packaging materials and so on) charged to the buyers.

### How to calculate VAT rebates for exports - "Exempt, Credit, Refund" ("ECR") method

The tax refund basis for export goods is very complicated. VAT refund for exported goods refers to a system of refunding the VAT already paid or payable in China to the exporter or granting VAT exemption to the exporter. This kind of VAT refund system is called the "Exempt, Credit, Refund" ("ECR") method. In brief, the VAT payable of a general VAT taxpayer under the ECR method is determined by applying the following formula:

VAT payable = Output VAT on domestic sales - [Total input VAT - Non-exempted and non-creditable VAT]

Non-exempted and non-creditable VAT

= (Export sales - bonded imports) x (VAT rate - applicable refund rate)

Bonded imports refer to those imports of raw materials or merchandise which would be used for the manufacture of exported goods. Generally speaking, no customs duties and import VAT would be levied on bonded imports.

The prevailing output VAT rate for general taxpayers is 17% whereas the applicable refund rates vary for different products.

From the above formula, if an enterprise exports merchandises which enjoy higher VAT rebates, it will lead to a lower amount of Non-exempted and non-creditable VAT. This will result

in a lower VAT payable. If the VAT payable is negative, this is a chance for applying for VAT refunds, subject to the applicable thresholds.

Please note that, in practice, the calculation of ECR is more complicated than the above formula as enterprises may conduct factory transfers or indirect export sales under which the merchandises are deemed exports for customs purposes whilst the same are physically transferred to another entity in China for further processing. From the administrative standpoint, the application of export VAT refunds needs to comply with the related PRC customs, tax and foreign exchange regulations as well as obtain the requisite documents. Otherwise, even though the merchandises have been physically exported, no export VAT refund is eligible.

## 2. Our Observation and Suggestion

The increase of VAT export refund rates would reduce the production costs of exported-oriented enterprises and strengthen their competitive capability. At the same time, enterprises should pay attention to their VAT compliance for the purposes of complying with the latest PRC tax regulations and fulfilling the requirements of PRC tax authorities.

Enterprises should be diligent in presenting sufficient and valid documentation such as export invoices, customs clearance records, foreign exchange receipts and verification / cancellation forms etc. to the PRC tax authorities so as to obtain VAT export refund.

Besides tax compliance, enterprises may wish to evaluate the mix of their domestic sales and export sales, the location of their operations, the flow of their supply chain, and other factors in order to make maximum use of preferential tax treatments.

Enterprises are recommended to consult tax advisors so as to devise a tax efficient operational structure and to perform regular tax health checks.

### Author

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## Recent e-Newsletters

- China Increases the Export Value-Added Tax Refund Rates for Textile Products, Certain Electronic Products and Other Commodities
- Measures for Determining Value of Goods and Articles Contravening the PRC Customs Regulations
- The Objectives and Benefits of an Internal Audit
- New transfer pricing regulations and their impact on foreign businesses in China
- Business Tax - Enlargement of scope of charge
- Shanghai: New provision on the establishment of regional HQs by foreign MNCs

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Insights is LehmanBrown's official client-focused e-newsletter. It offers updates on the latest business news, taxation and accounting regulations in the People's Republic of China. It is designed to provide you with interesting and informative information to assist in your dealings with China or any China-related issues that you may encounter.

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