

A summary on VAT export refund rules in China

The Chinese tax rules provide for three export refund methods: (i) the tax-exempt method, (ii) the pay-first-and-refund-later method, and (iii) the exempt-offset-refund method. The tax-exempt method has two variations: (a) the exporter has paid input VAT on the export goods, but the exporter is not entitled to any export refund; and (b) the exporter has not previously paid any input VAT on the export goods, and therefore the exporter is not entitled to export refund.

Under the pay-first-and-refund-later method or the exempt-offset-refund method, the exporter has no tax burden if the refund rate is equal to the standard rate. The exporter has tax burden if the refund rate is less than the standard rate. The exporter will have a higher working capital requirement if the pay-first-and-refund-later is adopted. As from 1st January 2002, all production type enterprise shall use the exempt-offset-refund method for export refund purposes. Commercial enterprises shall adopt the pay-first-and-refund-later method for export refund purposes.

[I] Export exemption with no credit for input VAT paid

Under the tax-exempt method, the buyer who exports his goods is not eligible for refund of the VAT paid on purchases, and therefore the buyer bears the cost of the input VAT. The following goods on which VAT has been paid for local purchases are not eligible for export refunds and they just receive the exemption treatment: (i) the goods that are banned from export under the Chinese law; (ii) the goods purchased by the exporter from small-scale taxpayer who cannot provide a VAT special invoice to the exporter; (iii) the goods purchased locally for used in export processing with supplied materials; and (iv) the goods on which the general taxpayer pays VAT at the levy rate and not at standard rate. The following elaboration helps. First, certain goods are prohibited from export fall into this category such as musk, bezoars (cow's gallstones), copper, platinum, cruel oil and diesel. Second, goods purchased from small-scale taxpayer are not eligible for export refunds even if they are actually shipped out of the PRC as export. The VAT rules specifically provide that if the exporter receives an ordinary tax invoice from the small taxpayer, the goods are not eligible for export refunds. However, if the small taxpayer pays the VAT, obtains a VAT invoice from the tax office and passes the invoice to the exporter, the goods are eligible for export refund.¹ Third, goods purchased locally for used in export processing with supplied materials are not entitled to export refunds. Export processing with supplied materials (*lai liao jia gong*) differs from export processing with purchased materials (*jin liao jia gong*) in that the former is only a contractual arrangement under which a Chinese party, situated inside the Chinese territories, undertakes processing or assembling work on materials provided by a foreign party and is paid a processing fee. The title to the goods in export processing with supplied materials remains with the foreign party throughout the period while they stay inside the PRC and therefore no export sales take place. In contrast, the legal title to the goods in export processing with purchased materials passes from the foreign party to the Chinese party under a purchase contract, and then after processing and assembling the legal title passes back to the foreign party under a contract of sales for exports. Fourth, the goods on which VAT is paid at levy rate are exempted from export VAT

¹ See document Guo Shui Han 248 (2005), issued by the State Administration of Taxation.

because the goods subject to VAT at levy rate are not entitled to input VAT credit in domestic sales. Exempt-offset-refund method shall apply to goods that are taxed at the standard rate (17%).²

[II] Export exemption with no previous payment of input VAT

If the export enterprise has not previously paid any VAT on the purchase, then these goods are not entitled to any export refunds. There are three originations of such goods: (i) the tax-exempt goods purchased locally for purpose of export such as the agricultural produce directly purchased from local farmers and fishermen, or the tax-exempt goods purchased for use in the manufacture of export goods; (ii) the bonded materials directly imported for use in export processing, indirectly imported from bonded warehouse or free trade zones; (iii) semi-finished bonded goods transferred from other export processing enterprise (upstream export processing enterprises) for further substantive processing.

[III] Export exemption with Input VAT paid and refunded upon export (exempt-offset-refund method)

The exempt-offset-refund method shall apply in the computation of export refunds for exporter of self-produced goods. In respect of export sales as from 1st January 2002, all production type enterprise exporting products made from local materials or bonded materials shall adopt the “exempt-offset-refund” method in the computation of disallowed credit, VAT payable, VAT offset, and the VAT refundable. “Exempt” here refers to the exemption of VAT for the export sales; “offset” here means the input VAT paid for the purchase used in the manufacture of export sales shall be offset against the output VAT collected on local sales; and “refund” here means if the amount of input VAT is larger than the VAT payable for the current period, the excess is refundable.³

Time to apply export refund

It is provided that export enterprise should produce all the required documents and submit application for export refund within 90 days from the date of export declaration. In case that the non-compliance is not rectified before the 15th day in the following month, all the export sales are deemed to be local sales and subject to VAT liability.⁴ The export enterprise shall make reclassify the export sale into domestic sale in the books and pay the VAT accordingly.

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² See document Article 10 in Guo Shui Fa 139 (2003), issued by the State Administration of Taxation.

³ See Article 2 of the document Cai Shui 7 (2002) jointly issued by the Ministry of Finance and the State Administration of Taxation.

⁴ See document Guo Shui Fa 113 (2004) issued by the State Administration of Taxation.