

Tax burden vs. tax rate

There is a difference between the VAT rate and the VAT burden. VAT rates (standard rate is 17%) are constant but VAT burden can be higher or lower than the VAT rates, depending upon the percentage of value added. An illustration could help explain the different tax positions. The VAT standard rate and the levy rate are 17% and 3% (6% and 4% for production and non-production taxpayers were applied before 2009.1.1.) respectively. Given that sale is 100 and purchase is 90, the value added is 10. The VAT payable is $10 \times 17\% = 1.7$. If the purchase is reduced from 90 to 70 in the same example, the value added is $30 = (100-70)$. The VAT payable is $30 \times 17\% = 5.1$. In both cases, the VAT payable is 3 ($=100 \times 3\%$) using the simple computation method.

	General computation	General computation	Simple computation
Sale amount	100	100	100
Purchase	90	70	
Value added	10	30	
Standard rate or levy rate	17%	17%	3%
VAT payable	1.7	5.1	3

Therefore one can observe that the general taxpayer could be better off by choosing the general computation method if the value added is lower than 3%. The general taxpayer will be better off by choosing the simple computation if the value added is higher than 3%. The taxpayer will be indifferent if the VAT payable under the two computation methods is the same. This can be verified if the purchase is changed to 82.35, then the VAT payable will be $17.65 \times 17\% = 3$. See note (1) below. To sum up, the percentage of value added and the VAT tax rate are not necessarily the same. For the general taxpayer, VAT is imposed on the amount of value added that are shown as $10=100-90$ and $30=100-70$ respectively in the above table. Its tax burden is related to the amount of value added. Therefore, it is very important for the general taxpayer to claim credit for the input VAT paid for its purchase. For the small-scale taxpayer, VAT is imposed on the sales amount. Its tax burden is the same as the tax rate.

Note (1): 17.65 is the percentage of value added that is arrived as follow: (selling price – purchase price) / selling price. That is $((100-82.35)/100 \times 100\%)$. If 17.65 is denoted by letter R, then at break even, the VAT standard rate will be the same as the levy rate: $\text{Sale} \times R \times 17\% = \text{Sale} \times 3\%$. Therefore we get 17.65% for R ($= 3\% / 17\% \times 100\%$).

VAT rates

There two sets of tax rates under the PRC VAT regulations. One set is the levy rate of 3% (6%, 4% and 2% respectively before 2009.1.1) under the simplified computation method. The other set of rates is 17%, 13%, and 0% respectively under the general

computation method. There will be no input credit if VAT is imposed using the simple computation with the levy rate.

Tax Rates applicable to VAT general taxpayers

I	17%	This 17% standard rate is applicable to the taxpayers selling and importing goods into China other than those listed in row II below.
II	13%	For the taxpayer selling and importing following goods: 1. Grain, edible vegetable oil, 2. Water, air conditioning, hot water, coal gas, LP gas, natural gas, methane gas, 3. Books, newspaper, magazines, 4. Animal feeds, fertilizer, agrochemicals, agricultural machinery, plastic covering film for farming 5. Other goods as specifically regulated by the State Council
III	0%	For the taxpayers who export goods (Note that taxpayer should apply for tax exemption. Otherwise the export sales are automatically taxed at 17%.)
IV	17%	For the taxpayers who supply services relating to processing, repairing, and replacement (taxable services)

Tax at levy rates (applicable to transactions before 2009.1.1.)

I	6%	Small scale taxpayer classified as production enterprise
II	4%	Small scale taxpayer classified as non-production enterprise
III	2%	Only applicable to the disposal of used fixed assets at above the cost by both the general taxpayer and the small taxpayer; See note (2) below.

Note (2): Since the input VAT paid for the acquisition (or importation) of fixed assets are fully creditable against the output VAT with effect from 2009.1.1, the disposal of fixed assets the VAT general taxpayer acquires after 2009.1.1 will be taxed at the full rate of 17%.

Tax at levy rates (applicable to transactions on and after 2009.1.1.)

I	3%	The rate applies to small-scale taxpayer who is engaged in production and non-production business alike.
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