

CHINA TAX ALERT

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VAT and duty rates for importation of aircraft adjusted upwards

Regulations discussed in this issue:

- Notice of the Ministry of Finance and State Administration of Taxation [2013] No. 53, Adjustment of VAT Policies for Importation of Aircraft ("Notice 53")
- Notice of the State Council Tariff Commission [2013] No. 31 about the Import Duty Rates for Certain Goods ("Notice 31")

The Ministry of Finance (MoF) and the State Administration of Taxation (SAT) jointly issued Notice 53 on 29 August 2013. According to this notice, effective 30 August 2013, the import Value Added Tax (VAT) rate for all aircraft with unladen weight of 25 tonnes or higher shall be increased to 5 percent from the previously reduced rate of 4 percent. Notice 53 abolishes the circular Caiguanshui [2004] No. 43 by which the MoF and the SAT promulgated the reduced rate in 2004.

Coming into force at the same time is Notice 31, which was promulgated by the State Council Tariff Commission on 26 August 2013. According to Notice 31, the provisional import duty rate of 1 percent, which applied to passenger aircraft with unladen weight of 25 tonnes and above, but not exceeding 45 tonnes (tariff code: ex88024010), has been abolished and replaced by the 'most favoured nation' rate of 5 percent.

Background

Over the last decade or so, the import VAT rate applicable on aircraft with unladen weight of 25 tonnes or higher has experienced a number of downward adjustments. A 10 percent VAT rate applied before 2001, and was reduced to 6 percent thereafter until Circular Caiguanshui [2004] No. 43 granted the reduced rate of 4 percent to airline companies on 1 October 2004.

In respect of import duties on passenger aircraft with an unladen weight of 25 tonnes or higher and not exceeding 45 tonnes, a 1 percent provisional duty rate has been in place since 1 October 1997.

KPMG's observations

Notice 53 adjusted upwards the import VAT applicable on airlines' importation of aircraft with unladen weight of 25 tonnes or higher. On the face of it, the adjustment increased the import VAT payable by airlines in China. However, it should not increase the actual cost for the airlines to import aircraft. This is because along with the nation-wide

expansion of the Business Tax (BT) to VAT reform for the transportation industry and several modern service industries, all airline companies in China have obtained the VAT general taxpayer status, which subjects them to VAT at 11 percent on their air transportation business and, in the meantime, allows them to credit qualifying input tax against their output. Airlines should be able to fully recover the import VAT paid through such a credit mechanism. As such, the reduced import VAT rate is not so relevant. The current upward adjustment of the import VAT rate should therefore not increase the cost of importing aircraft, although it may possibly have some impact on the airlines' cash flow due to the timing of the VAT credit and settlement.

Notwithstanding the above, Notice 31's restoration of import duty rate to 5 percent would have a substantial impact on the cost of the imported aircraft. Under the BT regime, airlines would need to account for import VAT (4 percent) into the cost of the aircraft. With the rolling out of the VAT reform, airlines no longer need to account for import VAT as part of the aircraft cost, but instead may credit the import VAT against their output tax, i.e., they would enjoy a structural tax reduction. The current upward adjustment of import duty is by four percentage points, however, it has, in effect, offset such structural tax reductions brought about by the VAT reform.

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