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CHINA TAX ALERT

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Recent China VAT Changes affecting Transport and Logistics

Changes to China's Value Added Tax (VAT) system from 1 August 2013 have increased the overall VAT burden on international air and sea transportation providers, their agents based in China, freight forwarders and other logistics service providers. This China Tax Alert summarises the changes, and outlines what can be done to alleviate the increased VAT burden, and how KPMG can assist.

In broad terms, these changes have typically resulted in an increased VAT burden of 6 percent, together with local surcharges of approximately 0.8 percent. Given the relatively small margins in the industry, these changes can significantly erode profitability.

Background

To understand the context of the changes, it is necessary to provide a brief background. Under the previous Business Tax (BT) system in China, transportation and logistics providers paid BT at the rate of 3 percent and 5 percent respectively. In calculating their BT liabilities, providers were eligible to deduct certain expenses from their revenue in calculating their BT liabilities. This was commonly known as the 'net basis' of accounting for BT.

Between 1 January 2012 and 31 July 2013, BT for the transportation and logistics industry was replaced by VAT progressively in a number of cities and provinces around China, including major cities such as Shanghai (1 January 2012), Beijing (1 September 2012) and Guangzhou (1 November 2012). Under the new VAT system, the VAT on domestic services within China applied at the rate of 11 percent for transportation services and 6 percent for logistics services. Small scale VAT taxpayers in those places paid VAT at the rate of 3 percent of their gross revenue.

During this period, transportation and logistics providers were still eligible to deduct certain expenses in calculating their VAT liabilities, such as overseas freight charges, port charges and handling charges, even where those expenses were not themselves subject to VAT. These deductions were commonly referred to as 'deemed input VAT credits'. This system was introduced as a transitional measure to ensure businesses in these sectors were not adversely affected during the period when other cities and provinces transitioned to VAT.

What has changed?

From 1 August 2013, the VAT system for the transportation and logistics sectors applies nationwide. China's Ministry of Finance (MoF) and the State Administration of Taxation (SAT) issued a new Circular Caishui [2013] 37, which had the effect of removing the ability to claim 'deemed input VAT credits'. This effectively meant that transportation and logistics providers were assessed for VAT purposes on their gross revenue (inclusive of overseas freight charges, port charges and handling charges) less input VAT credits. Deemed input VAT credits for expenses which were previously deductible for BT purposes could no longer be claimed. In many cases, this resulted in an increased effective VAT impost of 6 percent.

In addition to this, Circular Caishui [2013] 37 also abolished the previous 3 percent VAT withholding rate which had applied when an international transportation provider provided their services to a customer in China (or through an agent in China). That 3 percent VAT withholding rate applied to transportation providers from countries with which China did not have a bilateral treaty exemption. As a result of its abolition, the 3 percent VAT withholding rate changed to 11 percent, thereby increasing the disparity between transportation providers from treaty countries and those from non-treaty countries.

In addition to these changes, a number of other new issues of interpretation or administration have arisen, which have similarly affected transportation and logistics providers, including:

- International air and sea transportation services provided by the vast majority of Chinese providers are eligible for VAT zero rating – this compares favourably with the 11 percent VAT withholding rate now applicable to the services of international providers from non-treaty countries.

- Shipping agents based in China are being assessed for VAT purposes on the ocean freight charges collected on behalf of their foreign principal at the rate of 6 percent, instead of this revenue being disregarded in the hands of the agent (as happens in most other countries). Similar issues arise with respect to air freight and air travel, particularly for airlines with representative offices or agents in China.

- Where logistics services (other than warehousing services) are provided to overseas entities, the rules allow for an exemption from VAT. However, in practice, those rules have proven difficult to access in a number of cities and provinces in China. The absence of 'implementation rules' (which, broadly speaking, clarify the procedures and documentary requirements for seeking exemption from VAT) has exacerbated these problems. It is hoped that the implementation rules will be issued in the near future.

What can be done about it?

KPMG, along with a number of international transportation providers, have been engaged in extensive representations with the MoF and the SAT to seek solutions to overcome the increases in the tax burden arising from these changes. As of the date of issuing this China Tax Alert, no formal resolution has been applied, although officials are working hard to try to implement a solution, which would alleviate these concerns.

In the absence of any change to Circular Caishui [2013] 37, there are still a number of steps businesses can take to address the increased tax burden. The most appropriate step will depend on the specific circumstances of each provider, but may include:

1. Reviewing payment and remittance arrangements, particularly between international transportation providers and their agents or representative offices in China to minimise unnecessary payments flowing through China

2. Logistics providers, especially freight forwarders and agents, applying for exemption from VAT in respect of the services they provide to overseas counterparties, including their head offices or regional offices outside of China, where such treatment is beneficial based on their financial forecasts

3. Reviewing contractual arrangements to identify if VAT can be passed on to downstream customers

4. Reviewing pricing in light of these changes.

How can we help?

KPMG has developed a matrix which identifies, in respect of both imports and exports, freight forwarding services, shipping agency services and other logistics services, the precise impact of the VAT changes on different aspects of the cost structure of their businesses. This matrix allows for clear pricing decisions to be made based on these recent changes.

KPMG has also successfully assisted a number of businesses to apply for VAT exemptions for exported services, as well as changes to remittance arrangements to alleviate the impact of these changes.

A further critical support measure has been the assistance to downstream providers such as freight forwarders and their customers to ensure that the full effect of any concessions or benefits is accessed by their suppliers. We have also assisted providers in the preparation of clear communications with their suppliers and customers to highlight the impact of these changes, and steps which may be taken to alleviate price increases.

Finally, KPMG continues to engage in very active representation of industry with the MoF and the SAT to seek resolution of these issues. Further updates will be provided as developments unfold.

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