



China Leather VAT Issue

An Overview, Updated January 26, 2007

Many of you have heard rumors about the elimination of the Value-Added Tax (VAT) rebate and the implementation of import duties on leather in China and other rumors that a moratorium on these new rules. Obviously, these rules could significantly affect the cost of producing leather goods in China. Please find below the best information I have been able to put together on this situation.

This document, and the documents referenced herein, are available on the AAFA website at:
<http://www.apparelandfootwear.org/reports/chinaleatherVATissueoverview070126.pdf>.

HISTORY

The following Chinese agencies -- The National Development and Reform Commission, Ministry of Finance, Ministry of Commerce, Ministry of Land and Resources, The General Administration of Customs, The State Administration of Taxation, and The State Environmental Protection Administration -- issued [NDRC Circular 2595](#) on December 9, 2005. This NDRC Circular suspended processing trade (importation of raw materials then exported as semi-finished/finished goods) for certain products whose production was deemed environmentally harmful or energy-intensive. This notice mentions "imported raw skin and exported semi-produced leather or produced leather". This notice also stated that another circular would be shortly published removing the VAT export rebate for "raw skin, pelt, wet blue skin, wet leather and dry leather".

VAT EXPORT REBATE ELIMINATED

In a follow-up to NDRC Circular 2595, the National Development and Reform Commission, Ministry of Finance, Ministry of Commerce, Ministry of Land and Resources, The General Administration of Customs, The State Administration of Taxation issued Circular "Caishui" 139 ([Unofficial English Translation](#), [Appendix Listing Actual Tariff Numbers](#)) on September 14, 2006. The Circular -- which went into effect September 15, 2006 -- eliminated the VAT export rebate outright for all semi-processed/wet blue leather as well as cashmere.

Circular 139 reduced that VAT export rebate for the following products:

- All Finished Leather under HTS Chapter 41 - 13% to 8%
- Most yarns and fabrics under HTS Chapters 50-56 and HTS Chapters 59-60 - 13% - 11%
- Virtually all blankets, bed linen, table linen, kitchen linen, bath towels, curtains, bedspreads, furnishing articles, sacks and bags, tents, sleeping bags, sails and all other textile products listed under HTS Chapter 63 - 13% - 11%

FINISHED LEATHER

As noted above, the VAT export rebate for finished leather under HTS Chapter 41 (used in the production of finished leather products that are then exported) was not eliminated. The VAT export

rebate was only reduced from 13% to 8%. Further, nothing has changed in regards to import duties for finished leather – i.e. no import duties apply to imports of finished leather as long that leather is used in the production of leather products that are then exported.

IMPORT DUTIES – MORATORIUM NOW IN PLACE

Circular 139 made it clear that the products where China canceled the VAT export rebate will be listed in the *Catalogue of Forbidden Processing Trade*, which means import tariff and import linkage tax shall be levied on all commodities that are listed in the catalogue. ***Please note that there is NO indication anywhere that import duties will also be imposed on imported yarn and fabric OR, as noted above, finished leather used in finished products that are exported. The new import duties only apply to imported hides and semi-processed/wet blue leather.***

On the very same day that Circular 139 was issued (September 14, 2006), however, MOFCOM, the General Administration of the Customs and the State Environmental Protection Administration issued *The Notice Concerning Processing Trade of Raw Hides (Shang Chan Fa [2006] No. 390)* ([Actual Circular in Chinese](#)).

Circular 390 confirms that processing trade that imports raw hides and semi-processed/wet blue leather and exports finished leather and finished leather products can still import the raw hides and semi-processed/wet blue leather duty-free.

Circular 390 allows the following processing trade:

- Processing trade that imports raw hides and semi-processed/wet blue leather (4101-4108) and exports finished leather products (like shoes, leather clothes, bags, sofa case, etc.) and transfer of deep processing transaction;
- Processing trade enterprises can bonded import raw hides, then transfer the semi-finished or finished leather to downstream enterprises and the latter, after further processing, can export the finished products; and
- Processing trade enterprises can export semi-finished or finished leather to processing trade enterprises in special areas supervised by the customs (like bonded zones and export processing zones), or to downstream leather product manufacturing enterprises via the special areas supervised by the customs. The latter can further process the semi-finished or finished leather to leather products and export them to overseas market.

However, the Circular 390 imposes new strict requirements with regards environmental protection. Processing trade enterprises must obtain the certificate of environment protection from local environmental protection authorities to engage in processing trade.

Also, Circular 390 limits the quantity of enterprises engaging in processing trade of raw hides and semi-processed/wet blue leather. Only processing enterprises that engaged in such business in 2005 are eligible to apply for processing trade of raw hides and semi-processed/wet blue leather. The volume of raw hides and semi-processed/wet blue leather is tightly controlled too, an enterprise is not allowed to import more raw hides or semi-processed/wet blue leather imports than it did in 2005.

Please note the moratorium allowing processing trade in raw hides and semi-processed/wet blue leather expires December 31, 2008.

Circular #82 ([Unofficial English Translation](#), [Appendix Listing Actual Tariff Numbers](#)) (published November 1, 2006 and entering into force November 22, 2006) which, based on Circular #139 (as described above), confirms the moratorium by announcing the products that will be added to the *Catalogue of Forbidden Processing Trade (the "Catalogue")*. Products included in the "catalogue" are no longer exempt from import duties.

No form of leather (either semi-processed or finished) was included in circular #82 (nor was raw hides or skins under 4301).

WHAT DOES THIS MEAN FOR YOU?

These new rules mean that for companies that use raw hides and skins and semi-processed/wet blue leather in China for finished products the raw hides and skins and the semi-processed/wet blue leather they use are now subject to the full VAT of 17 percent

While a moratorium on duties on imports of raw hides and skins and semi-processed/wet blue leather (used in the manufacture of finished leather products that are then exported) is indeed in place, there are now restrictions on the quantity of those imports and importers are subject to new environmental restrictions. Further, the moratorium remains in place only until December 31, 2008, with the assumption that imports of raw hides and skins and semi-processed/wet blue leather would be subject to import duties after that date.

UNRESOLVED QUESTIONS

Based on recent conversations I have had with a few AAFA members, their suppliers in China have been providing them with information that seems to contradict what is stated above. Based on the information I have obtained to date, what is listed above is correct. However, I am checking on these unresolved questions now. These questions are:

1) There are rumors that the elimination of the VAT export rebate and the moratorium ONLY applies to hides and skins. Just like finished leather, semi-process/wet blue leather still receives a VAT export rebate (albeit reduced) and is NOT subject to import duties. While in everything I have read and in communications with the U.S. embassy in Beijing, it appears that the VAT export rebate has been eliminated for hides and skins AND semi-process/wet blue leather and the moratorium applies to both products, I am attempting to reconfirm this point.

2) There are rumors that the moratorium also applies to the elimination of the VAT export rebate. Circular #390, which imposes the moratorium, only refers to the import duties, but I am working with the U.S. government to reconfirm this point.

3) There are rumors that the moratorium does NOT impose any new restrictions on trade. Some restrictions already existed, but there is nothing new. Again, Circular #390 seems to specifically list a number of new restrictions, but I will work with the U.S. government to reconfirm this point.

NEXT STEPS

AAFA must decide next steps on this issue, particularly in light of the short duration of the moratorium and the new restrictions the moratorium places on trade.

Regrettably, it would likely be difficult to approach the U.S. government for assistance on this issue as the new rules don't seem to violate international trade rules under the World Trade Organization (WTO). On the VAT export rebate, China is just now applying the VAT to more products as it should have under WTO rules all along. As per import duties, the WTO allows the imposing of import duties as long as they are within bound rates. The only conceivable WTO violation is China's overt use of industrial policy -- a no no under the WTO. As you can see from the hyperlinks, China also reduced or eliminated the VAT export rebate and imposed import duties on a number of other items. At the same time, China significantly increased the VAT export rebate for a number of higher value-added industries like electronics.

Our other option is to band together with other organizations here in the United States -- like Footwear Distributors and Retailers of America (FDRA), the Leather Industries of America (LIA), and the International Fur Traders Association -- and our suppliers in China (through the China Leather Industry Association (CLIA) and others) to bring our case directly to the Chinese government. We are testing the waters on this approach with various meetings with Chinese officials here in Washington, DC. We have also already discussed the issue with LIA.

The U.S. government has already offered to help in any way it can. We are working with them to develop arguments as to why these measures are not in the best interest of the Chinese government.

Any input on possible approaches/next steps would be greatly appreciated.

Please contact AAFA's Nate Herman at nherman@apparelandfootwear.org or 703.797.9062 if you have any questions or would like additional information.