

Aristocraft of America, LLC v. United States

Consol. Court No. 15-00307, Slip Op. 18-97 (CIT August 8, 2018)

FINAL RESULTS OF REDETERMINATION PURSUANT TO COURT REMAND

A. SUMMARY

The Department of Commerce (Commerce) has prepared these final results of redetermination pursuant to the decision and remand order of the Court of International Trade (CIT or Court) in *Aristocraft of America, LLC v. United States*, Consol. Court No. 15-00307, Slip Op. 18-97 (CIT August 9, 2018) (*Remand Opinion and Order*). These final results of redetermination concern *Steel Wire Garment Hangers from the People’s Republic of China: Final Results of Antidumping Duty Administrative Review, 2013–2014*, 80 FR 69942 (November 12, 2015) (*AR6 Final Results*) and accompanying Issues and Decision Memorandum (AR6 IDM). On January 10, 2018, Commerce issued its *AR6 Remand I* in response to the first remand opinion and order from the Court.¹ In its August 9, 2018, *Remand Opinion and Order*, the CIT remanded for Commerce to further explain, and reconsider, if appropriate, how its deduction of taxes prohibited from exemption and offset accounts for an amount of input value-added-tax (VAT) not fully recouped on export sales that Shanghai Wells Hanger Co., Ltd (Shanghai Wells) includes in its price for export sales of finished wire hangers.²

¹ See *Final Results of Redetermination Pursuant to Court Remand Order in Aristocraft of America, LLC v. United States*, Consol. Court No. 15-00307, Slip Op. 17-132 (*AR6 Remand I*) at 9, accessed on September 5, 2018, at <http://ia.ita.doc.gov/remands/17-132.pdf>; see also *Aristocraft of America, LLC v. United States*, Consol. Court No. 15-00307, Slip Op. 17-132 (CIT September 28, 2017).

² See *Remand Opinion and Order* at 12.

As set forth in detail below, pursuant to the CIT's *Remand Opinion and Order*, we have further explained our adjustment for irrecoverable VAT. Consequently, for the purposes of these final results of redetermination on remand, we made no changes to the margin calculation for the mandatory respondent in the *AR6 Final Results*, Shanghai Wells. The period of review (POR) is October 1, 2013, through September 30, 2014.

On October 11, 2018, we released our draft results of redetermination to interested parties.³ On October 18, 2018, Shanghai Wells Hanger Co, Ltd., Hong Kong Wells Ltd., Hong Kong Wells Ltd. (USA) (collectively, Shanghai Wells), Best For Less Dry Cleaners Supply LLC, Ideal Chemical & Supply Company, Laundry & Cleaners Supply Inc., Rocky Mountain Hanger MFG Co., Rosenberg Supply Co., Ltd., and ZTN Management Company, LLC (collectively, U.S. Distributors), provided comments.⁴ We respond to these comments below. After considering these comments and analyzing the record, for purposes of this final remand redetermination, Commerce continues to make an adjustment for irrecoverable VAT in the amount of eight percent.

B. Irrecoverable VAT Adjustment

Background

In the *AR6 Final Results*,⁵ unchanged in the *AR6 Remand I*, we declined to use Shanghai Wells' proposed alternative calculation for its irrecoverable VAT because its calculation relied on allocations across all company sales and across sales of products with different VAT schedules, and because Shanghai Wells did not demonstrate that it was more appropriate than

³ See Department Letter re: Draft Remand Determination in the Antidumping Duty Administrative Review of Steel Wire Garment Hangers from the People's Republic of China; 10/01/2013-9/30/2014, dated October 11, 2018 (Draft Remand).

⁴ See Shanghai Wells and U.S. Distributors' Letter "Comments on Draft Remand," dated October 18, 2018 (Draft Comments).

⁵ See AR6 IDM at Comment 3.

Commerce’s standard irrecoverable VAT calculation methodology.⁶ In the *AR6 Remand I*, we explained that our calculation of Shanghai Wells’ irrecoverable VAT is derived from the “tax payable” formula in Chinese law that requires exporters to deduct an amount for “taxes prohibited from exemption and offset” from Shanghai Wells’ “input VAT,”⁷ thus reducing the amount of creditable VAT used to offset Shanghai Wells’ VAT liability to the Government of China. The formula for taxes prohibited from exemption and offset mirrors our calculation for the amount of the irrecoverable VAT.⁸ We further explained that accounting documentation maintained by Shanghai Wells in the normal course of business, particularly one specific accounting code, supports the calculation of an amount of irrecoverable VAT equal to approximately eight percent of the export value of Shanghai Wells’ finished hangers.⁹ In its *Remand Opinion and Order*, the CIT sustained as reasonable our finding that the accounting code in question records in Shanghai Wells’ books and records this amount of irrecoverable VAT.¹⁰ However, the CIT expressed doubt as to “how a reasonable mind would conclude that the amount of an input tax actually deducted from Shanghai Wells’ VAT liability is ‘not relevant’ to the adjustment of Shanghai Wells EP and CEP.”¹¹ Specifically, with respect to Commerce’s acknowledgement that “the deduction for ‘irrecoverable VAT’ is in some way linked to the amount of input VAT that Shanghai Wells actually pays,” the CIT asked: (1) whether the link was “not calculable;” (2) if the “link between Plaintiffs’ input VAT and tax paid

⁶ See *AR6 Remand I* at 2 and 6.

⁷ “Input VAT” is the amount of VAT paid on the purchase of inputs used to produce the goods sold. In this case, Shanghai Wells reported that “{f} or most of the material consumed to product (*sic*) the subject merchandise, the VAT tax rate of 17% is applicable to domestic purchases and imports.” See Shanghai Wells April 23, 2015 Supplemental Questionnaire Response (Shanghai Wells SuppCD) at 5-6.

⁸ See *AR6 Remand I* at 24-25; see also *Aristocraft of America, LLC v. United States*, 269 F. Supp. 3d 1316, 1325 (CIT 2017) (remanding to Commerce to further explain how the calculation of an eight percent irrecoverable VAT deduction from Shanghai Wells’ EP and CEP was reasonable).

⁹ *Id.* at 10-12.

¹⁰ See *Remand Opinion and Order* at 10.

¹¹ *Id.* at 11.

or refunded {is} generally not calculable (or knowable) because of the complexity of the Chinese VAT system (meaning it is just not possible); (3) if “it {is} at least theoretically possible to calculate (and account for the ‘link’ but not in this particular case because Plaintiffs have failed to proffer enough information and explanation against a dense and complicated Chinese VAT system to enable Commerce to make the (transaction-specific) adjustment to Plaintiffs’ EP and CEP;” or (4) if there is “something else going on.”¹² Thus, the CIT remanded for Commerce to “further explain, and reconsider, if appropriate, how its deduction of ‘taxes prohibited from exemption and offset’ accounts for an amount of ‘input VAT not fully recouped on export sales’ that Shanghai Wells includes in its price for export sales of finished wire hangers.”¹³

Analysis

For these final results of redetermination, Commerce continues to reduce Shanghai Wells’ prices by eight percent of the export price to account for irrecoverable VAT. Commerce has further reviewed its determination and the record evidence, and further explains its determination with respect to the amount of the deduction from U.S. price for irrecoverable VAT. Although the link between the amount of input VAT paid and our irrecoverable adjustment is evident in Shanghai Wells’ monthly VAT statements and relevant to the Chinese VAT scheme, it is not relevant to our *calculation* of the adjustment to U.S. price for irrecoverable VAT. Chinese law requires exporters to calculate the amount of irrecoverable VAT, which offsets the amount of their creditable input VAT which is used to reduce the amount of their VAT liability to the Government of China. This amount is based on a fixed percentage of the “free on board” (FOB) price of the exported goods, as established by the Government of China. According to Chinese law, this amount is to be included as a cost of the exported goods.

¹² *Id.* at 11-12.

¹³ *Id.* at 12.

Thus, we find it necessary to calculate the amount by which we reduce the export price used in our margin calculations on the same basis that Chinese law requires Shanghai Wells to calculate that expense included in its cost of exported goods.

As we explain below, although irrecoverable VAT is associated with input VAT in that it is an offset to the input VAT, which is a credit when calculating a firm's VAT liability, it is not directly relevant to our calculation of the amount of irrecoverable VAT that amounts to an "export tax, duty, or other charge" on Shanghai Wells' exports of subject merchandise as described in section 772(c)(2)(B) of the Tariff Act of 1930, as amended (the Act). Guided by the Chinese regulations, our calculation of the amount of irrecoverable VAT that amounts to an "export tax, duty, or other charge," considers only the FOB value of export sales, the value of duty- and VAT-free imports of inputs used in the production of goods for export, the VAT rate, and the refund rate specific to the export good. However, for the benefit of the Court's understanding, we also describe in depth below the function of the input VAT as it relates to Shanghai Wells' own VAT statements. Specifically, with respect to the Court's questions as to whether Commerce can know or calculate a link between the irrecoverable VAT and the amount of input VAT that Shanghai Wells already pays,¹⁴ we further explain that the link is calculable, in that the effect of irrecoverable VAT on Shanghai Wells' input VAT credit is plainly evident in Shanghai Wells' VAT statements. However, that link is not relevant to the calculation of our irrecoverable VAT adjustment because Chinese law requires irrecoverable VAT to be calculated on the basis of a percentage of export price, as was done in the *AR6 Final Results* and as we continue to do in these final results of redetermination.

¹⁴ See *Remand Opinion and Order* at 11-12.

VAT is an indirect, *ad valorem* consumption tax imposed on the purchase (sale) of goods. It is levied on the purchase (sale) price of the good, *i.e.*, it is paid by the buyer and collected by the seller. For example, if the purchase price is \$100 and the VAT rate is 15%, the buyer pays \$115 to the seller, which consists of \$100 for the good and \$15 in VAT. VAT is typically imposed at every stage of production. Thus, under a typical VAT system, firms (1) pay VAT on their purchases of production inputs and raw materials (input VAT) as well as (2) collect VAT on sales of their output (output VAT).

Firms calculate input VAT and output VAT for tax purposes on a company-wide (not transaction-specific) basis, *i.e.*, in the case of input VAT, on the basis of *all input purchases* regardless of whether used in the production of goods for export or domestic consumption, and in the case of output VAT, on the basis of *all sales to all markets*, foreign and domestic. Thus, a firm might pay the equivalent of \$60 million in total input VAT across all input purchases and collect \$100 million in total output VAT across all sales. In this situation, however, the firm would remit to the government only \$40 million of the \$100 million in output VAT collected on its sales because of a \$60 million credit for input VAT paid that the firm can claim against output VAT.¹⁵ As a result, the firm bears no “VAT burden (cost);” the firm, through the credit, is refunded or recovers all of the \$60 million in input VAT it paid, and the \$40 million remittance to the government is simply a transfer to the government of VAT paid by (collected from) the buyer with the firm acting only as an intermediary. Thus, the cost of output VAT falls on the buyer of the good, not on the firm.

This would describe the situation under Chinese law except that producers in China, in most cases, do not recover (*i.e.*, are not refunded) the total input VAT they paid. Instead,

¹⁵ The credit if not exhausted in the current period can be carried forward.

Chinese tax law requires a reduction in or offset to the input VAT that can be credited against output VAT. The formula for this reduction/offset is provided in Article 5 of the 2012 PRC government tax regulation, *Circular on Value-Added Tax and Consumption Tax Policies on Exported Goods and Services*:¹⁶

$$\text{Reduction/Offset} = (\mathbf{P} - \mathbf{c}) \times (\mathbf{T}_1 - \mathbf{T}_2),$$

where,

P = (VAT-free) FOB value of export sales;

c = value of bonded (duty- and VAT-free) imports of inputs used in the production of goods for export;

T₁ = VAT rate; and

T₂ = refund rate specific to the export good.

Using the example above, if P = \$200 million, c = 0, T₁ = 17% and T₂ = 10%, then the reduction/offset = (\$200 million - \$0) x (17% - 10%) = \$200 million x 7% = \$14 million.

Chinese law then requires that the firm in this example calculate creditable input VAT by subtracting the \$14 million from total input VAT, as specified in Article 5.1(1) of the *2012 VAT Circular*:

$$\text{Creditable input VAT} = \text{Total input VAT} - \text{Reduction/Offset}$$

Using again the example above, the firm can credit only \$60 million – \$14 million = \$46 million of the \$60 million in input VAT against output VAT. Since the \$14 million is not creditable (legally recoverable), it is not refunded to the firm. Thus, the firm incurs a cost equal to \$14 million, which is calculated on the basis of FOB export value at the *ad valorem* rate of T₁ – T₂. This cost therefore functions as an “export tax, duty, or other charge” because the firm does not incur it *but for* exportation of the subject merchandise, and under Chinese law must be

¹⁶ See Shanghai Wells’ June 1, 2015, Supplemental Questionnaire response (Shanghai Wells June 1 Response), at Exhibit 12, “Circular on Value-Added Tax and Consumption Tax Policies on Exported Goods and Services, Cai Shui 2012 No.39, May 25, 2012” (*2012 VAT Circular*).

recorded as a cost of exported goods.¹⁷ It is for this “export tax, duty, or other charge” that Commerce makes a downward adjustment to U.S. price under section 772(c) of the Act.¹⁸

It is important to note that under Chinese law the reduction/offset described above is defined in terms of, and applies to, total (company-wide) input VAT across purchases of all inputs, whether used in the production of goods for export or domestic consumption.¹⁹ The reduction/offset does not distinguish the VAT treatment of export sales from the VAT treatment of domestic sales from an input VAT recovery standpoint for the simple reason that such treatment under Chinese law applies to the company as a whole, not specific markets or sales. At the same time, however, the reduction/offset is calculated on the basis of the FOB value of exported goods, so it can be thought of as a tax on the company (*i.e.*, a reduction in the input VAT credit) that the company would not incur but for the export sales it makes, a tax fully allocable to export sales because the firm under Chinese law must book it as a cost of exported goods.

In its *Remand Opinion and Order*, the Court questioned how the amount of input VAT actually deducted from Shanghai Wells’ net VAT liability is “not relevant” to the adjustment of Shanghai Wells’ EP and CEP.²⁰ To further explain our statement in *AR6 Remand I* that “{t}he

¹⁷ Article 5(3) of the *2012 VAT Circular* states: “Where the tax refund rate is lower than the applicable tax rate, the corresponding differential sum calculated shall be included into the cost of exported goods and services.”

¹⁸ Because the \$14 million is the amount of input VAT that is not refunded to the firm, it is sometimes referred to as “irrecoverable input VAT.” However, that phrase is perhaps misleading because the \$14 million is not a fraction or percentage of the VAT the firm paid on purchases of inputs used in the production of exports. If that were the case, the value of production inputs, not FOB export value, would appear somewhere in the formula in Article 5 of the *2012 VAT Circular* as the tax basis for the calculation. The value of production inputs does not appear in the formula. Instead, as explained above, the \$14 million is simply a cost imposed on firms that is tied to export sales, as evidenced by the formula’s reliance on the FOB export value as the tax basis for the calculation. The \$14 million is a reduction in or offset to what is essentially a tax credit, and it is calculated based on and is proportional to the value of a company’s export sales. Thus, “irrecoverable input VAT” is in fact, despite its name, an export tax within the meaning of section 772(c)(2)(B) of the Act.

¹⁹ See, e.g., Article 5(1) of the *2012 VAT Circular*; Shanghai Wells SuppCD at Exhibits 17 and 18.

²⁰ See *Remand Opinion and Order* at 11.

aggregate input VAT that Shanghai Wells paid on purchases of materials that it used to make products, which it used in its alternative calculation for irrecoverable VAT, is not relevant to the calculation of the transaction-specific adjustment to U.S. price for irrecoverable VAT,”²¹ we rely upon the Chinese law, as explained above, in conjunction with the monthly VAT statements submitted by Shanghai Wells in the underlying review.²²

As explained above, the irrecoverable VAT expense is a liability calculated based on the VAT rate and the refund rate specific to the exported good, in this situation nine percent.²³ Shanghai Wells’ monthly VAT statements provide step-by-step guidance on the calculations, described in the *2012 VAT Circular*, that exporters are to carry out in order to arrive at their net VAT liability.²⁴ As illustrated in the hypothetical examples in Appendix I,²⁵ if a firm sells goods that are not subject to the irrecoverable VAT expense (*i.e.*, Company A), it is able to credit the total amount of input VAT paid as a deduction from the amount of output VAT collected from its downstream customers, the difference being its net VAT liability. If a firm sells some goods that are exported and thus subject to the irrecoverable VAT expense (*i.e.*, Company B), then it must deduct the irrecoverable VAT amount (*i.e.*, \$1.2 million) from the amount of the creditable input VAT before it is permitted to deduct that amount from the amount of output VAT collected from downstream customers. In this example, Company A’s output VAT is reduced (*i.e.*, offset) by the full amount of its input VAT paid (*i.e.*, \$10 million), and Company B’s output VAT is only partially reduced by its input VAT after deducting an amount corresponding to the value of its irrecoverable VAT (\$10 million - \$1.2 million = \$8.8 million). It is important to note that, but

²¹ See AR6 Remand I at 6.

²² See Shanghai Wells SuppCD at Exhibit 18 (VAT statements) (compiled in table format at Appendix II).

²³ See also Shanghai Wells SuppCD at 6.

²⁴ See Appendix II.

²⁵ The formulas included in this worksheet are the same as the formulas in the monthly VAT statements and the assumptions here mirror the facts in the underlying administrative review, *i.e.*, the VAT rate for hangers is 17 percent and the rebate rate is 9 percent.

for the deduction of irrecoverable VAT from its input VAT credit, Company B would have been granted a credit equal to its total input VAT paid, effectively recovering 100 percent of its input VAT paid; instead that credit was reduced by \$1.2 million to \$8.8 million, rendering \$1.2 million of its input VAT paid unrecovered and increasing Company B's net VAT liability to the government by \$1.2 million. This example illustrates how a firm's irrecoverable VAT results in a payment to the government in the amount of the FOB value of the exported goods times the difference between the VAT rate and the refund rate specific to the exported good.²⁶ Chinese VAT law instructs firms to record this irrecoverable expense as a cost of goods sold so that the exporter may recover that portion of the input VAT that is foregone as a result of the exportation of the products and the generation of irrecoverable VAT that otherwise would have been fully credited against their output VAT if the product had not been exported.²⁷ The record demonstrates that Shanghai Wells booked approximately eight percent of its exported steel wire garment hanger export value to its accounting records as irrecoverable VAT and considered it as a cost of its sales of steel wire garment hangers.²⁸

Shanghai Wells' situation, as illustrated in Appendix II using Shanghai Well's own VAT statements on the record of this administrative review,²⁹ differs from the hypothetical example in Appendix I in that [] of its sales [] and, thus, subject to the irrecoverable VAT provision of Chinese VAT law. As described above, the impact of irrecoverable VAT is plainly evident in the amount of "total deductible tax" available to Company B in the single-month scenario presented at Appendix I. However, Shanghai Wells'

²⁶ See Article 5.1(1) of the 2012 VAT Circular.

²⁷ See Article 5(3) of the 2012 VAT Circular.

²⁸ See *AR6 Remand I*; see also Shanghai Wells' February 9, 2015, Section C and D Questionnaire Response (Shanghai Wells CDQR) at Exhibit R-4 and Shanghai Wells June 1 Response at Exhibit 1.

²⁹ See VAT statements.

VAT statements underscore how China's complex system of liabilities, deductions, offsets, and exemptions, with carryover amounts between periods and adjustments reflecting calculations from prior periods,³⁰ can obscure the impact of irrecoverable VAT on the input VAT credit. Furthermore, it demonstrates that input VAT credits and reductions for irrecoverable VAT are not forgiven in any single month because input VAT credits are carried over from month to month. Notwithstanding these company-wide accounting procedures regarding total VAT liability to the Government of China, the record demonstrates that Shanghai Wells' irrecoverable VAT results in an increased VAT liability to the government based on a percentage of the value of its FOB sales, and that the existence of this increased VAT liability is solely due to the exportation of subject merchandise.

Although, as stated above, input VAT is not a variable included in the calculation of the adjustment to U.S. price for irrecoverable VAT, pursuant to the Court's order, we further explain the function of input VAT. The input VAT and irrecoverable VAT, along with output VAT, all relate to overall net VAT liability, but input VAT is not relevant to our calculation of a transaction-specific irrecoverable VAT expense, which is based on the calculation required of exporters by Chinese law, and uses the variables with which exporters are required by Chinese law to calculate the amount of their irrecoverable VAT expense. Moreover, in this context, input VAT is not relevant to the calculation of export price because it is a credit to an exporter's output VAT, not a cost that is relevant for antidumping duty purposes. The important point is that the amount of VAT that is irrecoverable, in essence, becomes an export-contingent tax and, therefore, is properly considered an "export tax, duty, or other charge" described in section 772(c)(2)(B) of the Act that must be deducted from export price.

³⁰ See also *AR6 Remand* at 9-10.

As illustrated by Shanghai Wells' VAT statements, if a firm's "total deductible tax" (which is equal to the amount of its input VAT paid plus an amount of its deductible VAT paid carried over from a prior month, minus the amount of its irrecoverable VAT) is greater than the amount of the output VAT collected from its customers, then the amount of its "actual tax deductible" becomes its output VAT and the difference between its output VAT and total deductible tax, *i.e.*, its "Tax retained end of this month," can be credited forward to the next month as its tax "Retained last month" (compare box 20 with box 13 in Appendix II).³¹ Thus, for an exporter such as Shanghai Wells, its output VAT is often [], resulting in an []. The difference between its "total deductible tax" and its "actual tax deductible" is then transferred to the next month as its tax "retained last month." As illustrated in Appendix II, as the firm's deductible tax³² is serially transferred from one month to the next, it is continually reduced by the amount of irrecoverable VAT incurred in that period. Thus, the effect of the irrecoverable VAT expense is not isolated to a single month but, rather, continues to affect the offsetting of the input VAT credit in subsequent months.

As demonstrated in Appendix II, in [] of the POR, Shanghai Wells' input VAT credit was [] by its irrecoverable VAT and the [] was allowed to be []. However, because Shanghai Wells' irrecoverable VAT was [] its input VAT in [] of the POR, its input VAT credit was [] and the amount it was

³¹ See also Article 5.1(3) of the 2012 VAT Circular.

³² A firm's "deductible tax" is the sum of its creditable input VAT plus an amount retained and carried forward from the previous month, minus its irrecoverable VAT; see Appendix II at box 17 (although the formula in box 17 also includes adjustments for "Refundable tax for exemption, offset, refund of goods" and "Overdue tax payable," the record provides no detail indicating that these variables have an effect on the amount of irrecoverable VAT incurred).

allowed to carry forward from the prior month was [] by its irrecoverable VAT. In fact, on a POR-wide basis, Shanghai Wells' total input VAT credit, [], was [] by its total irrecoverable VAT liability, [], and the amount [] would be carried forward to continue to affect the offsetting of its output VAT in future periods. This relationship underscores another reason why the input VAT paid by Shanghai Wells is not relevant to the irrecoverable VAT *calculation* during the POR; not only is irrecoverable VAT calculated on a different basis than input VAT, but the effect of the irrecoverable VAT expense is not tied to input VAT paid in any particular month. Thus, to the extent that Commerce may not be able to link the input VAT to the deduction for irrecoverable VAT on any given record, the input VAT paid is not relevant to the calculation of irrecoverable VAT, which is based in Chinese law. In addition, the amount of irrecoverable VAT is not dependent on either the amount of output VAT or the amount of net VAT liability.

It is important to note that while the interplay between irrecoverable VAT and input VAT has a direct effect on the overall VAT tax liability of a firm, we must emphasize that it is not the overall net VAT liability of Shanghai Wells with which we are concerned, but the effect of the irrecoverable VAT expense on the exporter's ability to offset its tax liability by its input VAT credit, and the recording of the irrecoverable VAT expense as a cost of goods sold. Most importantly, the effect of the irrecoverable VAT expense on the exporter's ability to offset its tax liability by its input VAT credit is not a function of the VAT rate paid on inputs, the value of those inputs, or the aggregate amount of input VAT paid but is a function of the FOB selling price of the finished goods and the difference in the VAT rate and the VAT refund rate for those

finished goods,³³ an amount that Chinese law requires an exporter to build into the cost of its exported goods. The Act requires that we reduce the export price or constructed export price used in the antidumping margin calculation by “the amount, if included in such price, of any export tax, duty, or other charge imposed by the exporting country on the exportation of the subject merchandise to the United States, other than an export tax, duty, or other charge described in section 771(6)(C)” of the Act.³⁴ Commerce’s irrecoverable VAT adjustment deducts the amount of irrecoverable VAT that was included in the selling price of steel wire garment hangers to the United States and is calculated on the same basis (*i.e.*, percentage of FOB price) that Chinese law requires exporters build into their cost of goods sold. In this administrative review, that figure is eight percent.³⁵

Thus, after reviewing the administrative record, Commerce continues to find that “{t}he aggregate input VAT that Shanghai Wells paid on purchases of materials that it used to make products, which it used in its alternative calculation for irrecoverable VAT, is not relevant to the calculation of the transaction-specific adjustment to U.S. price for irrecoverable VAT.”³⁶ Accordingly, we are making no changes to the *AR6 Final Results* with respect to our calculation of the amount of irrecoverable VAT deducted from Shanghai Wells’ export price.

C. INTERESTED PARTY COMMENTS

On October 11, 2018, Commerce released the draft results of redetermination to all interested parties.³⁷ We invited parties to comment on the draft results of redetermination by

³³ See Article 5.1(1) of the *2012 VAT Circular*.

³⁴ See Section 772(c)(2)(B) of the Act.

³⁵ See Shanghai Wells SuppCD at 6-7.

³⁶ See AR6 Remand I at 6.

³⁷ See Draft Results of Redetermination Pursuant to Court Remand, *Aristocraft of America, LLC v. United States*, Consol. Court No. 15-00307, dated October 11, 2018 (draft remand).

October 16, 2018.³⁸ On October 15, 2018, at the request of Shanghai Wells and U.S. Distributors, we extended the comment period to October 18, 2018.³⁹ Shanghai Wells and U.S. Distributors submitted comments on October 18, 2018.⁴⁰ No other interested party submitted comments.

Issue: Irrecoverable VAT Adjustment

Shanghai Wells and U.S. Distributors' Comments:

- Commerce still has not addressed the Court's concern that input VAT is not relevant to any adjustment to Shanghai Wells prices.⁴¹
- Although Commerce acknowledges that the Chinese VAT system takes input VAT into account, it illogically concludes, without any basis in law or fact, that input VAT should be ignored for purposes of the calculation of EP or CEP.⁴²
- Commerce acknowledges that to express a company's VAT liability one must take into account the input VAT and output VAT, but "boldly" claims that for antidumping purposes it is reasonable to ignore input VAT.⁴³
- The difference between the input VAT and the output VAT is the company's VAT liability, and therefore both liabilities are considered by the company in determining its sale prices needed to achieve profitability.⁴⁴

³⁸ *Id.*

³⁹ See Shanghai Wells and U.S. Distributors' Letter, "Steel Wire Garment Hangers from the People's Republic of China – Request for Additional Time to Comment on Draft Results," dated October 12, 2018.

⁴⁰ See Draft Comments.

⁴¹ *Id.* at 3.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.* at 4.

- By characterizing VAT as a sales tax, Commerce demonstrates how the adjustment is not permitted by the statute, because the statute only allows such an adjustment for an “export tax, duty or other charge” and if it is included in the price.⁴⁵
- Nothing in the record indicates that Shanghai Wells charges its foreign customers eight percent in irrecoverable VAT and affirmative evidence proves that it does not.⁴⁶
- If irrecoverable VAT is an export tax, the statute does not permit Commerce to deduct it because it is not included in the selling price.⁴⁷
- If VAT might theoretically be included in the price because VAT is a factor in determining profitability, the net VAT amount must be considered so both the input VAT and output VAT must be considered in making an adjustment, as Shanghai Wells has already provided in its responses.⁴⁸
- Commerce should use the calculation of Shanghai Wells’ overall VAT burden expressed as a percent of the sale price that was provided by Shanghai Wells.

Commerce’s Position:

We disagree with Shanghai Wells and U.S. Distributors that our draft results of redetermination did not address the Court’s concern that the input VAT is not relevant to an adjustment required for Shanghai Wells’ prices. As a general matter, Shanghai Wells mischaracterizes Commerce’s determination and analysis with respect to the input VAT and the link between input VAT and Commerce’s irrecoverable VAT adjustment. Shanghai Wells and U.S. Distributors state that although our draft remand “provide{d} roughly ten pages of

⁴⁵ *Id.*

⁴⁶ *Id.* (citing to Shanghai Wells Section A Response, dated January 8, 2015 (Shanghai Wells SAQR), at Exhibit 5).

⁴⁷ *Id.*

⁴⁸ *Id.* at 4-5 (citing to Shanghai Wells SuppCD at 7 and Exhibit 17).

examples of how the Chinese VAT system works” and acknowledged that the system takes into account the input VAT on raw materials, our draft remand illogically concluded that for purposes of the calculation of EP or CEP input VAT should be ignored.⁴⁹ However, in this remand, as described above, we explained that the link between the input VAT and irrecoverable VAT is a reduction in the input VAT credit that can be applied to an exporter’s overall net VAT liability in an amount equal to the irrecoverable VAT adjustment. Further, that amount is defined by Chinese law, which also requires that the amount for irrecoverable VAT must be included in the exporter’s cost. We also explained that the link between input VAT and irrecoverable VAT is evident in Shanghai Wells’ VAT statements, which show that Shanghai Wells’ input VAT credit was reduced in each month of the POR by the amount in its “Irrecoverable VAT” account.⁵⁰ Shanghai Wells and U.S. Distributors’ characterization of Commerce’s determination overlooks this detailed explanation of the relationship between input VAT and irrecoverable VAT and does not respond to our position that input VAT paid is not relevant to our *calculation* of the irrecoverable VAT adjustment to EP or CEP because irrecoverable VAT is defined in Chinese law as being directly proportionate to a defined percentage of FOB sales value. Most importantly, as explained above, input VAT plays no role in the calculation of irrecoverable VAT as defined in Chinese law.

As explained in *AR6 Remand I*, Article 5.3 of the 2012 VAT Circular, *i.e.*, the Chinese law, clarifies that for irrecoverable VAT, “{w}here the tax refund rate is lower than the applicable tax rate, the corresponding differential sum calculated shall be included into the cost of the exported goods and services.”⁵¹ Accordingly, as also described in *AR6 Remand I*, because

⁴⁹ *Id.* at 3.

⁵⁰ See also Appendix II and VAT statements

⁵¹ See *AR6 Remand I* at 8-9, 10, and 26.

Shanghai Wells considers irrecoverable VAT to be a cost of producing subject merchandise, its sale price includes the cost of irrecoverable VAT, as directed by the 2012 VAT Circular.⁵² Indeed, Shanghai Wells reported in the underlying review that it “sets prices by taking into consideration its production costs, other cost items, selling expenses, and an estimated profit margin”⁵³ and its accounting records establish that irrecoverable VAT is an integral component of Shanghai Wells’ cost structure and would therefore be passed on to its customers.⁵⁴

Although Shanghai Wells and U.S. Distributors claim that the statute does not permit Commerce to deduct irrecoverable VAT because it is not “included in such price,”⁵⁵ the record demonstrates otherwise. Specifically, accounting documentation demonstrates that Shanghai Wells calculates its cost of sales as the [],⁵⁶ where the cost of its finished goods is based on the [], as detailed in subledgers submitted by Shanghai Wells.⁵⁷ The total cost of sales (*i.e.*, the []) recorded in Shanghai Wells’ accounting records flows directly to its income statement in its audited financial statements as its “Cost of primary business.”⁵⁸ Moreover, the accounting documentation submitted by Shanghai Wells demonstrates that the amount of irrecoverable VAT that Shanghai Wells was required by Chinese law to consider a cost of its export sales was [] because its sales revenue [] its cost of sales in each month of the POR. Specifically, as

⁵² *Id.* at 11.

⁵³ See Shanghai Wells SAQR at 14.

⁵⁴ See, *e.g.*, Shanghai Wells CDQR at R-4.

⁵⁵ See Draft Comments at 4.

⁵⁶ See Shanghai Wells CDQR at Exhibit R-4, “Cost of Sales” subledger.

⁵⁷ See Shanghai Wells SuppCD at Exhibit 35, Finished Goods subledger and [] “Basic Cost of Manufacturing” general ledger, “Salaries” general ledger, and “Overhead” general ledger; *see also* Appendix III for a summary of the data submitted by Shanghai Wells.

⁵⁸ See Shanghai Wells CDQR at Exhibit R-4, “Income Statement” for 2013 line item “Cost of primary business” ([]), compared to “Cost of Sales” general ledger total for 2013 ([]).

detailed in Appendix III, Shanghai Wells' monthly cost of sales, which includes its irrecoverable VAT expense, comprised between [] of its monthly sales revenue and averaged [] for the POR.⁵⁹ Accordingly, the record establishes that Shanghai Wells records irrecoverable VAT as a cost of exporting steel wire garment hangers,⁶⁰ that its costs are a factor considered when Shanghai Wells sets its prices, and that those costs were [] by its sales revenue generated in each month of the POR.

Moreover, with respect to Shanghai Wells' and U.S. Distributors' argument that Commerce should use the calculation of Shanghai Wells' overall VAT burden expressed as a percent of the sale price that was provided by Shanghai Wells, we also disagree. As discussed in *AR6 Remand I*, Shanghai Wells' alternative calculation is neither supported by Chinese law nor the record of this review.⁶¹ Specifically, whereas our irrecoverable VAT adjustment is intended to calculate the amount identified in the 2012 VAT circular as "taxes prohibited from exemption," and mirrors the formula used in the Chinese regulations, Shanghai Wells' alternative calculation represents a complete departure from that formula without explanation.⁶² In fact, the formula for Shanghai Wells' alternative calculation appears nowhere in the Chinese law. Whereas our irrecoverable VAT adjustment properly calculates the reduction to Shanghai Wells' input VAT credit as the product of FOB price and the applicable unrefunded VAT rate, Shanghai Wells' alternative approach calculates the irrecoverable VAT amount (*i.e.*, Applicable VAT rate - VAT Refund Rate) and then inexplicably deducts input VAT paid from that amount.⁶³ As explained at length above, input VAT is not included in the calculation of the adjustment to

⁵⁹ See Appendix III.

⁶⁰ See, *e.g.*, Appendix II.

⁶¹ See *AR6 Remand I*, at 9.

⁶² We also note that Shanghai Wells' proposed alternative calculation does not adhere to the calculation for overall VAT tax liability in the Chinese law (Output Tax – (Input Tax – Irrecoverable VAT)). See 2012 VAT circular at Article 5(1).

⁶³ *Id.* at 26 (citing to Shanghai Wells SuppCD at 7 and Exhibit 17; Shanghai Wells' June 1 Response at Exhibit 10).

U.S. price for irrecoverable VAT. Accordingly, we continue to find that Shanghai Wells' alternative calculation produces an entirely different result than the formula in the 2012 VAT circular and is, therefore, not supported by the Chinese law or by the record of this review.

In sum, the irrecoverable VAT adjustment applied to Shanghai Wells' EP and CEP adjusts for an expense, codified in Chinese law, that is based on the FOB value of the exported merchandise and the statutorily defined VAT rate and VAT refund rate. The amount of irrecoverable VAT serves as a reduction in Shanghai Wells' creditable input VAT, which determines its overall net VAT liability to the Chinese government. This reduction in the amount of creditable input VAT, as provided by the Chinese law, must be recorded as a cost for the export sales. Accordingly, the statutorily mandated irrecoverable VAT serves as an "export tax, duty, or other charge" as it is an expense paid to the government which would not be incurred but for the exportation of the subject merchandise. Because the irrecoverable VAT expense is calculated, according to Chinese law, as a function of FOB price without regard to the amount of input VAT actually paid, input VAT is not relevant to our calculation of Shanghai Wells' irrecoverable VAT adjustment. Shanghai Wells records an amount for irrecoverable VAT in its accounting records equal to approximately the same amount that Commerce deducted from its prices using our standard methodology.⁶⁴ That amount is accounted for in the amount booked to Shanghai Wells' cost of sales subledger and flows directly to the costs recorded in Shanghai Wells' audited financial statements.⁶⁵ Shanghai Wells considers such production costs when setting its U.S. prices, and those costs, including irrecoverable VAT, were [

] by the revenue generated on Shanghai Wells' sales of subject merchandise during the POR. Accordingly, we find that the record supports the position that irrecoverable VAT is an

⁶⁴ See *AR6 Remand I* at 11, 26, and 28.

⁶⁵ See Shanghai Wells SuppCD at Exhibit R-2.

“export tax, duty, or other charge” that is imposed by the exporting country on the exportation of the subject merchandise to the United States that is included in Shanghai Wells’ selling prices and that must be deducted from EP or CEP, pursuant to section 772(c)(2)(B) of the Act.

D. FINAL RESULTS OF REDETERMINATION

Pursuant to the Court’s remand order, we have reconsidered our calculation of the irrecoverable VAT adjustment and, in doing so, have reexamined the administrative record and provided further explanation and analysis of our decision in the *AR6 Final Results*. As a result, in these final results of redetermination, we continue to make an adjustment for irrecoverable VAT in the amount of eight percent of the FOB value of the subject merchandise.

11/9/2018

X 

Signed by: CHRISTIAN MARSH

Christian Marsh
Deputy Assistant Secretary
for Enforcement and Compliance