

# Chinese VAT reform

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# Development of VAT System in China

- 1979 Introduced VAT in several cities within several industries in China
- 1994 Established new tax system, in which VAT applied to all goods, Business Tax (“BT”) applied to almost all services (& real estate), Consumption Tax (which is similar to excise duty) applied to some items of goods
- 2009 Allowed the creditability of input VAT incurred on the purchase of fixed assets (i. e. equipment)

# Development of VAT System in China

- 2012 Started reform pilot program in Shanghai to replace BT with VAT in transportation and certain modern service industries
- 2013 Expanded the above pilot program across China
- 2014 Expanded the industry scope to postal services, railway and telecommunication services
- 2016 Expanded the industry scope to Construction services, Financial services, Sales of immovable properties, Sales of intangible assets



# Why Replace BT with VAT (BT2VAT)?

- In 2015, VAT & BT raised almost 40% of total tax revenue in China. BT is a cascading turnover tax – it is a tax on business, and it applies to each stage of the supply chain so it “cascades”. By contrast, VAT is neutral for business through the credit offset system
- Promote social division of labour, the development of the services sector and therefore the Chinese economic transition
- Moving to a single indirect tax system (VAT) for both goods and services means:
  - Businesses which manufacture, distribute or sell goods can claim input credits for the services purchased; and
  - Businesses which provide services change to pay VAT such that they can claim input credits for the goods (incl. fixed assets) & services purchased
- However, shifting from BT to VAT changes:
  - The duty of tax collection and administration on pilot industries; which need shift from local tax authorities to state tax authorities;
  - The tax revenue sharing arrangement among central & local governments; almost all of BT revenue belongs to the local governments while only 25% of domestic VAT revenue goes to local governments (in addition to the 75%, the central government also has 100% import VAT revenue but needs to provide funding for VAT export refund.)

# Scope of VAT pilot arrangements

- **Sales of service**
- Transportation Services (Land transportation/ Water transportation/ Air transportation/ Pipeline transportation)
- Postal Services (General postal services/ Special postal services/ Other postal services)
- Telecommunications Services (Basic telecommunications services/ Value-added telecommunications services)
- Construction services (Engineering services/ Installation services/ Renovation services/ Decoration services/ Other construction services)
- Financial services (Loan services/ Direct financial services/ Insurance services/ Financial product trading)



# Scope of VAT pilot arrangements

- Modern services includes: R&D and technology services, R&D services, Contractual energy management services, Engineering reconnaissance and exploration services, Professional technology services, Information and technology services, Software services, Circuit design and testing services, Information system services, Business process management services, Value-added information system services, Cultural and creative services, Design services, Intellectual property services, Advertising services, Convention and exhibition services, Logistics supporting services

# Scope of VAT pilot arrangements

- Continued Modern Services: (Air services, Port services, Freight and passenger station services, Salvage services, Loading, unloading and carrying services, Warehousing services, Collection and delivery services, Leasing services, Financial leasing services, Operating leasing, Identification and consulting services, Certification services, Identification services, Consulting services, Radio, film and television services, Production services, Distribution services, Broadcasting services, Business supporting services, Enterprise management services, Brokerage and agent services, Human resources services, Security and protective services, Other modern services)
- Life-style service includes: (Cultural and sports services, Education and medical services, Catering and accommodation services, Daily services, Other life-style services)
- **Sales of intangible assets**
- **Sales of immovable properties**



# Two classes of VAT payer and applicable VAT rate

- Two classes of VAT payers:
- General VAT payers, with annual sales turnover of VATable supplies exceeding RMB 5,000,000
- Small-scale VAT payers, with annual sales turnover of VATable supplies not exceeding RMB 5,000,000 (please note that it is possible for small-scale VAT payers to voluntarily apply to become general VAT payers)



# Two classes of VAT payer and applicable VAT rate

- For General VAT payers:
- 17% Tangible property leasing services 17%
- 11% Transportation services, postal services, basic telecommunication services, construction services , immovable property leasing services, sales of immovable property, transfer of land use right
- 6% Value-added telecommunication services, financial services, modern services other than tangible property leasing services, life-style services, sales of intangible assets

# Two classes of VAT payer and applicable VAT rate

- For Small-scale VAT payers:
- All VATable supplies
- 3% or 5% (for real estate development companies selling self-developed real estates)

# Determination of place of supply

- The supply of services, intangible goods and immovable properties would refer to the following:
- Either the supplier or the recipient of services (except for the lease of immovable properties) or intangible assets (except for natural resource user right)
- The sold or leased immovable properties is located in China



# Determination of place of supply

- The natural resource for which the user right is sold is located in China
- Other situations regulated by the MOF and SAT
- The following supplies would be considered as outside of China:
- Overseas entities or individuals supply taxable services or intangible assets which are completely consumed overseas to entities or individuals within the territory
- Overseas entities or individuals lease tangible property that are completely used overseas to entities or individuals within the territory
- Other circumstances regulated by the MOF and SAT

# Output VAT

- Output VAT shall be computed by the following method:
- Output VAT = Sales amount X Applicable VAT rate
- If the consideration received by the supplier is VAT inclusive amount, output VAT shall be computed as: Output VAT = VAT-inclusive sales amount  $\div$  (1+ Applicable VAT rate) X Applicable VAT rate

# Input VAT

- VAT incurred by general VAT payers from the purchase of goods, expenses related to receiving processing repair and maintenance services, as well as receiving VATable services could be treated as input VAT. The following input VAT amounts are allowed to be deducted from output VAT:
- VAT amount indicated on a special VAT invoice (including uniform invoice of automobile sales, the same hereinafter) issued by the supplier
- VAT amount indicated on the Import VAT Payment Certificate
- Other than the VAT amount indicated on a special VAT invoice and Import VAT Payment Certificate, the calculated 13% of the purchase value of agricultural products indicated on invoices
- VAT amount indicated on the Tax Payment Receipt (withholding VAT) obtained from tax bureaus, where the purchase of service, intangible assets or immovable assets is made from overseas entities or individuals





# Future Reform Goals of Chinese VAT

- Simplify the multiple VAT rates: To reduce the compliance uncertainties and the distortion of the operation of multiple VAT rates (incl. 17%, 13%, 11%, 6% and 3%)
- Apply the zero rate to exported services & more exported goods: Most of exported services are currently exempt from VAT and input VAT incurred on related cost is not creditable. May consider applying the zero rating to exported services and also more exported goods



# Future Reform Goals of Chinese VAT

- Refund excessive input VAT credit: Excessive VAT input credit is currently not refunded but can be carried forward (indefinitely). May consider providing VAT refund to certain industries and taxpayers
- Abolish small scale taxpayer: Small scale taxpayers are subject to simplified VAT method (which means they pay output VAT at 3% of gross revenue, with no input VAT credits) - similar to BT