



# China: Country VAT Essentials Guide 2017

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# Introduction



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THE 2017 EDITION OF THE CHINA COUNTRY VALUE ADDED TAX (VAT) ESSENTIALS GUIDE PROVIDES AN OVERVIEW OF THE INDIRECT TAX SYSTEM IN MAINLAND CHINA. IT IS INTENDED TO ASSIST COMPANIES DOING BUSINESS IN OR WITH CHINA TO NAVIGATE THE INDIRECT TAX SYSTEM.

## Background

China's indirect tax system was for many years a bifurcated system with VAT broadly applying to the goods sector, and Business Tax (BT) applying to the services sector. In 2012, the Chinese Government embarked upon extensive indirect tax reforms to replace BT, which was generally regarded as an inefficient turnover tax as it taxed businesses at each stage of the supply chain, with a VAT for services industries. The application of VAT for services industries was introduced by way of a pilot program which involved the VAT rules for certain sectors being implemented progressively on a province by province basis, however more recently the implementation of VAT has been done nationwide on an industry-by-industry basis. On 1 May 2016 the VAT pilot program was completed following the expansion of VAT to financial services and insurance, real estate and construction, and lifestyle services, resulting in VAT replacing BT for all services sectors.

China's VAT system is now amongst the broadest based systems amongst over 160 countries in the world which have now implemented a VAT (or equivalent tax). China's VAT system is unique by international standards in applying VAT to most financial services (including interest income), and in applying VAT to real estate transactions involving not only business-to-business (B2B) and business-to-consumer (B2C) transactions, but consumer-to-consumer (C2C) as well.

This guide provides a broad overview of the key features of China's VAT, and is presented in a way which should be readily accessible to an international audience. While the guide provides an overview of the key features of China's VAT system, in many cases the challenge in China is the implementation of these outcomes at a local level.

KPMG's team of indirect tax professionals are well placed to advise you in effectively navigating the tax environment in China.





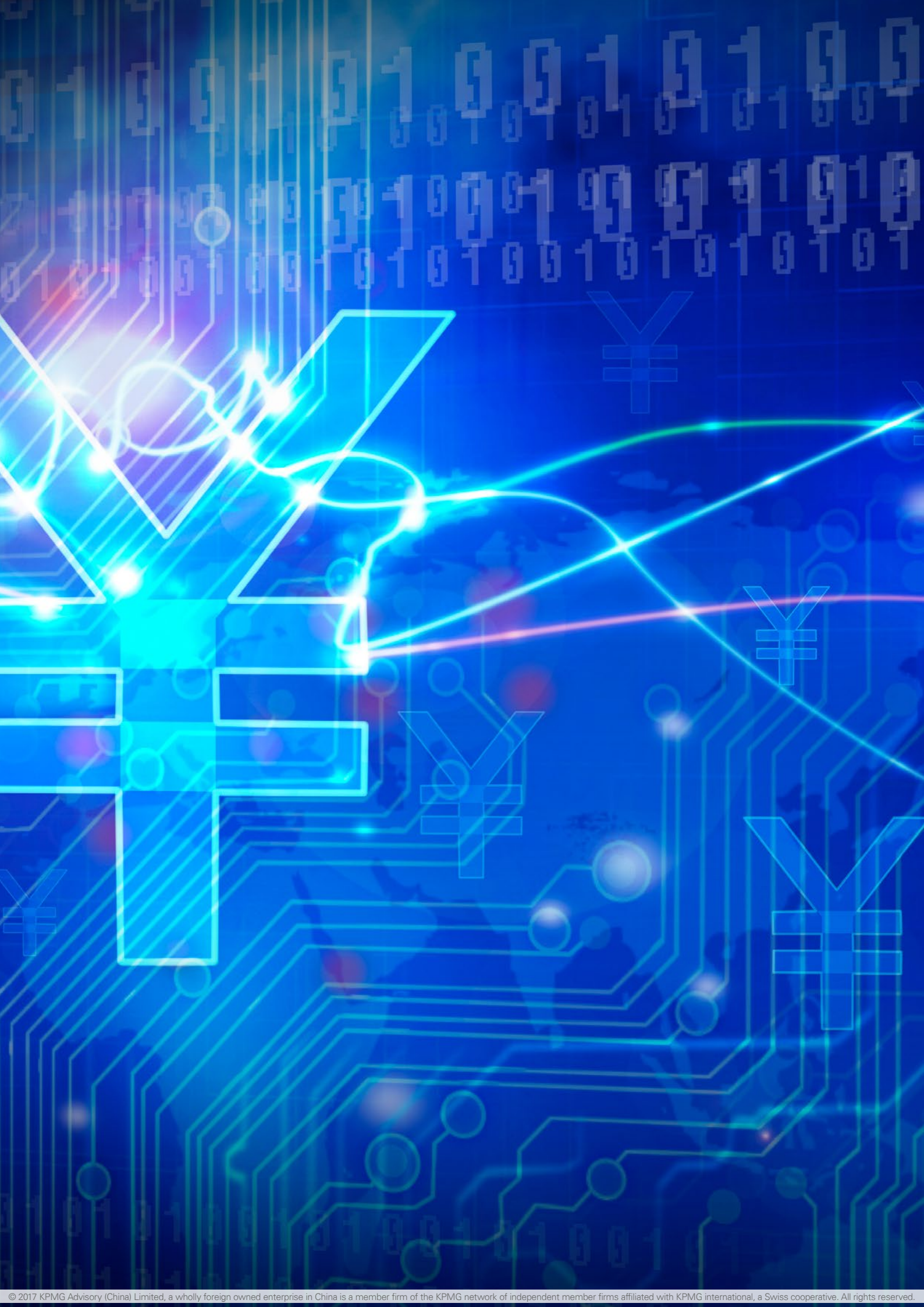
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# Significant indirect tax developments at a glance



**Have any significant changes occurred in your country over the past few months?**



**Are any significant changes expected over the coming months?**



Historically, China had a Business Tax (BT) system for services, and a VAT for goods. However, from 1 May 2016 the VAT pilot program was completed in China and VAT now applies to both goods and services (with BT now abolished). China's VAT system is amongst the broadest based systems amongst over 160 countries in the world which have now implemented a VAT (or equivalent tax). China's VAT system is unique by international standards in applying VAT to most financial services (including interest income), and in applying VAT to real estate transactions involving not only business-to-business (B2B) and business-to-consumer (B2C) transactions, but consumer-to-consumer (C2C) as well.

The Chinese Government has issued a number of Circulars in the past year to clarify uncertainties and update the rules under the new VAT system, such as:

- Starting from 1 July 2017, goods that were previously subject to a rate of 13%, e.g. agricultural products, natural gas etc., were reduced from 13% to 11%.
- Starting from 1 January 2018, new VAT rules for the operation of asset management products, such as trusts and funds.



It is expected that in the next few years China will move from a multiple rate VAT system to a system with fewer VAT rates. The current VAT rules are also expected to be enacted into legislation (which gives them added formality), though in practical terms the enforcement and collection of VAT is accepted and applied notwithstanding the current informality.

The Consumption Tax (CT) system is also anticipated to be the subject of reforms over the coming months, which may potentially alter the categories of goods subject to CT, the applicable rates and the point of imposition and collection.

# Scope and Rates



## What supplies are liable to VAT?



There are two main forms of indirect taxes operating in mainland China: VAT and Consumption Tax (CT). Until recently, China also operated a business tax (BT) regime, however from 1 May 2016 this has been fully replaced by VAT.

VAT can now potentially apply to the sale and importation of all goods in, from or to China, and the provision of all services in, from or to China. VAT in China exhibits some of the features of other VAT regimes throughout the world (albeit with some uniquely Chinese characteristics), in the sense that it taxes final private consumption expenditure (as well as some public expenditure), by generally relieving the burden of VAT on transactions between businesses through an input VAT credit mechanism.

CT applies to the manufacturing, processing, importation or selling of 15 different kinds of goods in China, principally luxury goods.

The VAT and CT comments in this guide relate to mainland China only, and do not include the Special Administrative Regions of Hong Kong and Macau. Currently neither Hong Kong or Macau have either a VAT, GST or equivalent indirect tax. Given that indirect taxes in mainland China have been subject to significant reforms recently and are expected to be subject to further change, we recommend you contact a KPMG China advisor for the most up to date advice.



## What is the standard rate of VAT?



The standard rate of VAT is 17 percent for general VAT taxpayers. The standard rate of 17 percent is applied to the sale and importation of most goods, the provision of repair, replacement and processing services, as well as the leasing of tangible moveable assets. Reduced rates of VAT apply to many other services, as outlined below. CT rates differ depending upon the stage of production at which the sale occurs, type, weight, or capacity. Given the application of CT is both limited and specific to the type of goods being sold, it is not proposed to discuss CT further.



## Are there any reduced rates, zero rates, or exemptions?



Yes.

The following are the main examples of reduced rates, zero rates and exemptions: in China as follows:

- 3% – ‘small-scale taxpayers,’ being those without sophisticated business, accounting and auditing systems and whose turnover is below certain thresholds (ranging from RMB 500,000 to RMB 5,000,000 for services which have recently transitioned from BT to VAT). These small-scale taxpayers pay output VAT at 3%, but cannot claim input VAT credits on purchases. The 3% ‘simplified VAT rate’ also applies to certain construction services and revenue from asset management products (meaning that output VAT is paid at 3%, but no input VAT credits can be claimed on purchases).



- 5% - this is the simplified VAT rate applicable to certain real estate transactions, and is effectively a transitional measure applied to certain real estate transactions held at 1 May 2016.
- 6% – ‘modern services’ (being research and development and technical services, information technology services, cultural and creative services, logistics and ancillary services, certification and consulting services, radio, film and television services), value added telecommunications services (e.g. data based telecommunications), financial and insurance services and ‘lifestyle services’ (being education, healthcare, travel, entertainment, food and beverage, accommodation, citizens daily services and cultural and sports services).
- 11% – transportation services, postal services, basic telecommunications services (e.g. voice based telecommunications), real estate and construction services (though many real estate and construction transactions are subject to reduced rates of VAT pursuant to transitional or grandfathering rules from 1 May 2016). From 1 July 2017, the 11% rate also applies to the sale of food grains and vegetable oils, heating, air conditioning, certain gas supplies, books, newspapers and magazines.
- Zero-rated – exported goods; certain exported services (though most exported services are exempt, not zero-rated, see section below on “exported services” for further information). However, unlike in many other countries, the refund provided on zero rated goods is, in many cases, less than the amount of VAT incurred on inputs.
- Exempt - agricultural products, contraceptive drugs and devices, antique books, certain exported services (see section below on “exported services” for further information).
- Out of scope of VAT – interest income on deposits derived by financial institutions, claims paid by insurers and certain merger and acquisition activities.

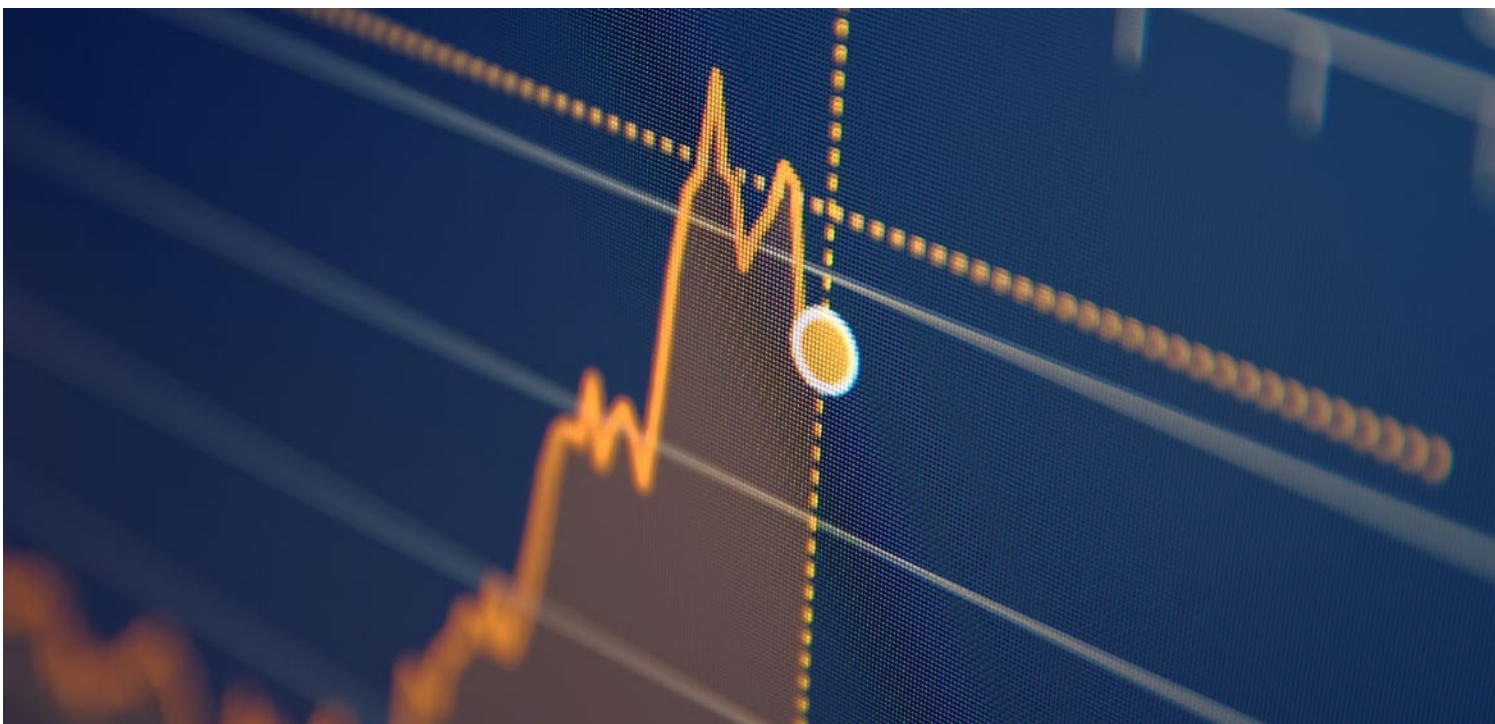


## What are the other local indirect taxes beside VAT?



Other indirect taxes include:

- customs duty
- stamp duty
- various local levies, such as the Urban Maintenance & Construction Tax and Education Levy
- various real estate specific taxes, motor vehicle taxes and mining specific taxes.



# Registration



## Who is required to register for Chinese VAT?



Generally speaking, foreign entities are not eligible to register as general VAT taxpayers in China. Instead, foreign entities wishing to enter the Chinese market typically do so through the establishment of a Chinese foreign invested commercial enterprise (FICE), wholly foreign owned entity (WFOE) or a Joint Venture, or they may operate within a free trade zone (or equivalent). The tax system in China is more or less linked to the business licensing / registration system and to foreign currency controls, so practically there can be real limitations on foreign entities wishing to do business in China without a local presence. There are exceptions to these principles, such as representative offices which may be able to operate, albeit with limited functions.

The remaining discussion relates primarily to Chinese entities.

There are two separate concepts relevant here - thresholds for liability for VAT purposes, and the separate threshold for registration as a "small scale taxpayer" or "general VAT taxpayer".

The VAT thresholds for liability apply only to individuals. Businesses and other "units" automatically have VAT liabilities on their taxable transactions, irrespective of turnover. However, even for individuals, the thresholds are very low - ranging from RMB5,000-20,000 per month of sales, or RMB300-500 per transaction in the majority of provinces in China.

"Small scale taxpayers" are those with annual sales turnover of not more than:

1. RMB 800,000; or
2. RMB 500,000 if engaged solely or mainly in the production of goods or in the provision of repair, replacement and processing services; or

3. RMB 5 million if providing all other services, being those services which have recently transitioned from BT to VAT.

Registration as a "small scale taxpayer" or "general taxpayer" determines whether:

- VAT is payable at 3 percent, with no eligibility for input tax credits on purchases (small scale taxpayers) and generally no eligibility to issue special VAT invoices; or
- VAT is payable in the usual way with input tax credits generally available for business purchases.

It is possible for taxpayers that would otherwise be "small scale taxpayers" to register as "general VAT taxpayers". They need to demonstrate a sound accounting system and provide accurate tax information as well as having a fixed place of business in China and be approved by the tax authority.

The consequences of being registered as either general taxpayer or a small scale taxpayer is summarised as follows:

	General taxpayer	Small scale taxpayer
Output VAT	Yes, at various rates depending on the goods or services being supplied	3%
Input VAT credits	Yes, can generally claim	No, cannot claim
Issue special VAT invoices	Yes	No except for certain small-scale taxpayers in pilot industries*, but can request their tax authority to issue special VAT invoices on their behalf.
Receive special VAT invoices	Yes	No

\* According to recently published regulations, VAT small-scale taxpayers in certain industries are involved in a pilot scheme which will allow them to issue special VAT invoices.



## Are there penalties for not registering or late registration?



As noted previously, the concept of registration for VAT purposes is, in practice, really more applicable to registration as a “general VAT taxpayer”. General VAT taxpayers are required to register, by filing the form for the “Approbation of General Taxpayers of VAT” within 40 days after a tax period during which they were required to register. Separate procedures apply for “small scale taxpayers” in terms of the documentation which must be filed.

There are penalties for failing to register, which include fixed amount fines and fines which are a combination of interest and penalties. The tax authorities have the authority to revoke business licenses for failing to register.



## Is voluntary VAT registration possible for an overseas company?



Generally, no. Foreign companies cannot generally register for VAT purposes in China. Instead, they typically establish foreign invested commercial enterprises (FICEs), wholly foreign owned entities (WFOEs) or enter into joint ventures, as a means of doing business in China. Alternatively, they may establish themselves in a Free Trade Zone (or equivalent) where their sales are mostly for export purposes.

Where a foreign company provides services to a recipient in China, the VAT will typically be collected on a withholding basis by the recipient in China – that is, the VAT is withheld from the price and accounted for by the recipient in China. Where a foreign company sells goods into China, the VAT on importation is typically accounted for by a local customs agent on their behalf, or by the buyer.



## Is there any other kind of VAT registration?



Generally, no.



Q

**Can businesses recover input VAT incurred prior to the registration?**

A

No.

Q

**What documentation does an overseas company need for the VAT registration?**

A

Not applicable.

Q

**Are there any simplifications that could avoid the need for an overseas company to register for VAT?**

A

As noted previously, foreign entities cannot generally register for VAT in China.

Please note that the answer to this question depends, to a significant extent, on regulatory issues which impact on the way in which foreign entities can do business in China, not merely VAT issues.

Q

**What rules must be complied with in order for the triangulation simplification to be applied?**

A

Not applicable.

Where an overseas company provides services which are subject to VAT, and it does not have a trading establishment in China, the recipient of the service in China is the withholding agent. This is particularly relevant where an overseas company without operations in China makes supplies subject to VAT to another entity in China. Both the overseas company and the local recipient are jointly and severally liable for the VAT.

Q

**Does an overseas company need to appoint a fiscal representative?**

A

No, see above.



## Q Is call-off stock implemented in your country?

A No.

## Q Is consignment stock implemented in your country?

A No.

## Q Consignment stock simplification

A In China, the consignment of goods is regarded as a 'deemed sale' for VAT purposes. This means that VAT is payable on the 'sale' by the consignor to the consignee, and then again by the consignee to the customer. There is a mandatory 4 percent VAT rate applicable to the sale of goods by consignment shops.

## Q How the supply of goods installed or assembled is treated?

A The supply of installation and assembly services, in addition to the supply of goods, would ordinarily all be subject to 17% VAT, though there may be situations where the installation or assembly service could be structured as a separate service.

Generally though, where a taxpayer provides taxable services/goods which are subject to different tax rates (i.e. mixed sales), the sales amount should be separately itemized according to the relevant VAT rate or type of service/good. If the amount is not separately itemized, the highest tax rate of the services/goods provided applies, so there is a strong incentive to ensure itemization occurs.

## Q Is a foreign company who is supplying goods locally liable to register for VAT?

A Please note that the answer to this question depends, to a significant extent, on regulatory issues which impact on the way in which foreign companies can do business in China, not merely VAT issues.

From a regulatory perspective, ordinarily foreign companies doing business in China who operate through FICEs (foreign invested commercial enterprises) or WFOEs (wholly foreign owned enterprises) can register as general VAT taxpayers provided they meet certain conditions.



# VAT Grouping

Q

Is VAT grouping possible?

A

Grouping of different legal entities is not generally possible in China. Moreover, in many cases, branches or offices of the same legal entity may be required to separately account for transactions, particularly where they operate in different provinces. Transactions between a head office and a branch or between branches may even be subject to VAT.

A regulation has been issued which would allow branches of the same legal entity that are subject to the VAT pilot program to seek approval to group for VAT purposes. The specific implementation rules under which this framework will be operational at an administrative level are yet to be generally introduced. At this stage, only in certain industries such as the airline industry has this been allowed.

Q

Can an overseas company be included in a VAT group?

A

Not applicable.





# Returns



## How frequently are VAT returns submitted?



VAT returns must be submitted either every 1 day, 3 days, 5 days, 10 days, 15 days, 1 month or 1 quarter, depending on the taxpayer's activities. While these timeframes may be imposed, in reality most taxpayers lodge monthly. Banks and certain other businesses providing financial services (except insurers) lodge quarterly.



## If a business receives a purchase invoice in foreign currency, which exchange rate should be used for VAT reporting purposes? (E.g. central bank's exchange rate applicable on the date of the invoice)



It is common practice that taxpayers in China convert any foreign exchange balances using the middle exchange rate published by the People's Bank of China either on the day the transaction is recognized for accounting purposes, or on the first day of the month in which the tax is paid on the transaction. Taxpayers are not entitled to switch methods within the course of a year.



## Are there any other returns that need to be submitted?



Yes. The main VAT filing form and the five appendices are mandatory forms. If applicable, the other forms listed below may also need to be completed and submitted to the tax authority:

- VAT filing return (main form);
- Appendix 1 – Details of sales for current period;
- Appendix 2 – Details of input VAT for current period;
- Appendix 3 – Details of deductible items for taxable services, immovable property and intangible asset;
- Appendix 4 – Details of prepaid and reduced VAT;
- Appendix 5 – Details of immovable property subject to phased VAT credit approach;
- Detailed information of input tax credits for fixed assets;
- Detailed information of input VAT credit for current period;
- Detailed information of VAT reduction and exemption;
- VAT withholding payment voucher;
- "Exempt, Credit and Refund" filing form for exported services subject to VAT zero rating (International and HK/Macao/Taiwan Transportation);
- "Exempt, Credit and Refund" filing form for exported services subject to VAT zero rating (R&D / Design service).

In addition to this, certain local taxes and surcharges are payable as a percentage of the VAT payable, and returns are lodged for this purpose.

# VAT Recovery



**Can a business recover VAT if it is not registered**



**Local/established businesses which incur VAT**

No, a business must be registered as a general VAT taxpayer in order to claim an input VAT credit. Refunds of excess input VAT credits are not generally given (except for certain exports) – instead, the credit balance may be carried forward (potentially indefinitely) and used to offset output VAT.

**Overseas businesses with no local presence and no local VAT registration**

No - only businesses registered as general VAT taxpayers are eligible to claim input tax credits for VAT purposes, and overseas businesses will not generally be allowed to register.



**Does your country apply reciprocity rules for reclaims submitted by non-established businesses?**



No.



**What are the general conditions for claiming a deduction of input VAT?**



In order to claim input VAT credits in China, the business must be registered as a general VAT taxpayer, they must obtain a special VAT invoice, the expense must relate to deriving taxable revenue which is subject to VAT, and the special VAT invoice must be verified within 360 days of its receipt.



## Q Are there any items that businesses cannot recover VAT on?

**A** There are a number of restrictions on the recovery of input tax credits, the most significant of which is that only general VAT taxpayers are potentially eligible to claim and that claims must be supported by special VAT invoices. Special VAT invoices are highly regulated in China. As such, assuming the taxpayer is a general VAT taxpayer and holds a special VAT invoice, then further restrictions include an inability to claim for:

- inputs related to the simplified method of calculating VAT;
- inputs related to the sale of tax-exempt items;
- inputs related to group welfare activities (e.g. employee canteens and employee benefits);
- inputs related to the purchase of food and beverage and entertainment services;
- inputs related to interest expense;
- those for personal consumption; and
- inputs used in deriving extraordinary or abnormal losses.

For completeness, it should also be noted that many exports of goods do not result in full recovery of VAT. That is, there may be a leakage in export VAT recovery.

## Q Can businesses recover input VAT on certain employee expenses?

**A** As a general proposition, in considering the categories of expenses below, it is assumed that:

- the taxpayer is a general VAT taxpayer;
- the taxpayer is a domestic Chinese entity; and
- the expense is not related to a “group welfare activity”.

### Domestic Air Travel

Domestic air travel within China has been subject to VAT nationwide from 1 August 2013. Under a special rule, businesses are not generally eligible to claim input VAT credits for their employees’ business travel.

### International Air Travel

International air travel is generally zero rated for Chinese airlines but exempt from VAT for international airlines (typically because the international airlines do not have the appropriate legal structure or licenses that would allow them to zero rate).

### Rail Travel

Railway travel has generally been subject to 11% VAT from 1 January 2014. However, under a special rule businesses are not eligible to claim input VAT credits for their employees’ business travel.

### Taxi Fares

Taxi services became subject to VAT from 1 May 2016 as a lifestyle service. The rate of VAT is 6% if the taxi provider is registered as a general VAT taxpayer, or 3% if it is a small scale taxpayer. Under a specific rule businesses are not generally eligible to claim input VAT credits for their employees’ business travel, which includes land (e.g. taxi) transportation.

### Car Rental

Car rental became subject to VAT from 1 May 2016. Under a specific rule businesses are generally not eligible to claim input VAT credits for transportation related costs, e.g. car rental.





**Fuel**

VAT recovery would not be available where such expenses are regarded as related to welfare and private consumption. However, if such expenses are incurred for business purposes, and assuming the employee could obtain a special VAT invoice, then an input VAT credit may be available.

**Car parking**

Car parking became subject to 11% VAT from 1 May 2016. Under a specific rule businesses are generally not eligible to claim input VAT credits for transportation or staff welfare related costs.

**Hotels**

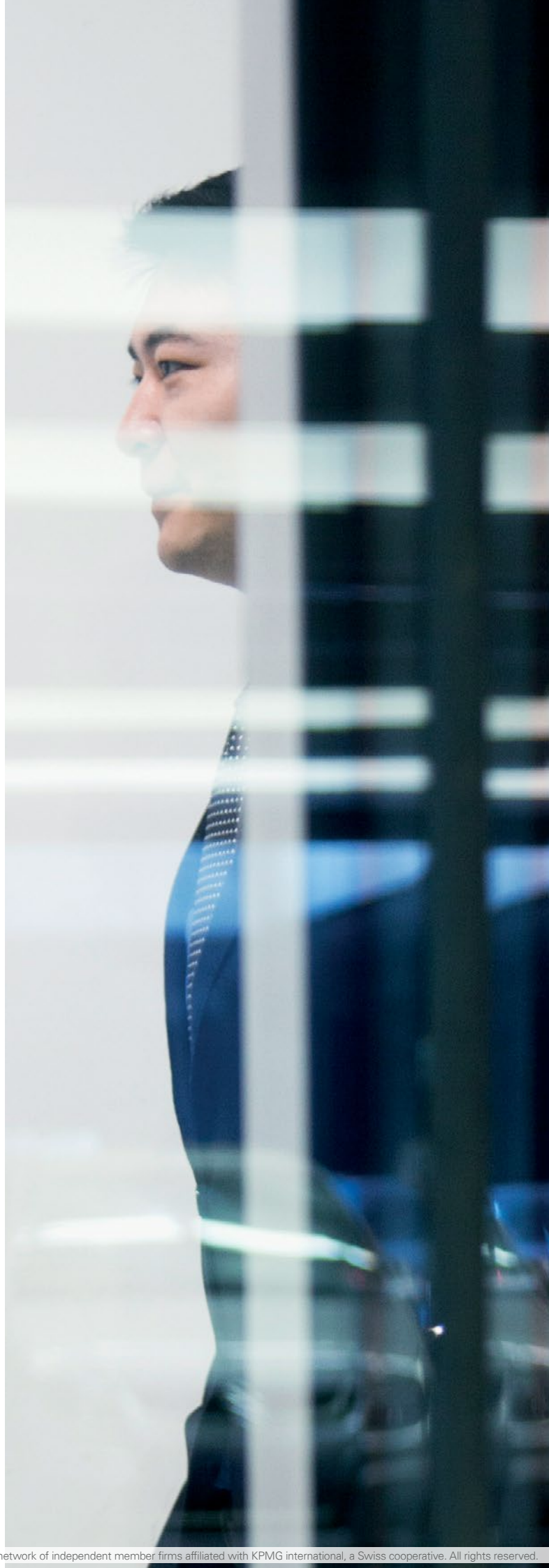
Accommodation services became subject to 6% VAT from 1 May 2016 as a lifestyle service. Employees staying at a hotel for business purposes who are employed by general VAT taxpayers may be eligible to claim an input VAT credit. However, the input VAT credit will not be available where the guest is an individual staying for reasons of personal consumption. A special VAT invoice should be obtained and issued in the name of the employer.

**Client and Staff Entertainment and Meals**

Food and beverage (F&B) services became subject to 6% VAT from 1 May 2016 as a lifestyle service. The VAT rules specifically provide that input VAT credits are disallowed for all F&B services.

**Telephone Calls**

Telecommunications services became subject to VAT from June 2014 onwards. An employee's telephone calls in relation to a landline or a mobile phone account in the employee's name would not be recoverable for VAT purposes. However, if the landline or mobile phone account is in the employer's name and the employer is registered as a general VAT taxpayer and obtains a special VAT invoice, then an input VAT credit should be available.



## Q Can expenses related to only partially taxable business be deducted?

A Yes.

For fixed assets, the VAT recovery rules for general VAT taxpayers in China are relatively generous by international standards. Provided the asset is not solely used for a non-creditable purpose (e.g. group welfare activities, or in activities exempt from VAT), then full input tax credit recovery is available.

For all other goods and services (i.e. other than fixed assets), VAT may be recovered on an apportionment basis, depending on their use. A direct attribution is generally required, and for any remaining items, apportionment is generally conducted on a revenue basis.

## Q Can a VAT registered business claim a refund of input VAT paid where the input VAT exceeds the output VAT payable or is it obliged to carry the excess credit forward and set it against future output VAT payable?

A Where input tax exceeds output tax in any given period, generally the excess may be carried forward indefinitely rather than resulting in a refund. The main exception to this is for exports of goods, and those exported services which are zero rated, such as international transport, radio, film and television services for overseas entities, research and development, offshore outsourcing services and IT services provided to overseas entities. Initially eligible businesses can be required to wait for 6 months or greater before they receive the refund.

VAT taxpayers are not generally eligible to claim a refund of excess VAT credits – instead, the excess VAT credit balance is carried forward (potentially indefinitely) and used to offset output VAT.

The only exception where refunds may be obtained is in respect of zero rated exports of goods, and exports of certain zero rated services such as international transportation, radio, film and television services for overseas entities, research and development, offshore outsourcing services and IT services provided to overseas entities.

## Q Are there any other special rules relating to the recovery of VAT in your country?

A No.



# International Supplies of Goods and Services

## EXPORTS - GOODS



### How are exports of goods treated?



Exports of goods are treated as zero rated for VAT purposes. The mechanics of the way zero rating is achieved may differ depending on the type of company. For example, exports of goods by manufacturing companies, are subject to what is known as the Export, Credit, Refund method ("ECR method"). That is:

- exports are exempt from VAT;
- input tax on purchases used in exporting is first credited against output tax on domestic sales; and
- excess input tax is refunded to exporters.

Goods exported overseas by China based trading companies apply what is known as the Levy First, Refund Later method ("LFRL method"). Under this method, the trading company pays VAT on the purchase, which is passed through by the local supplier. When it exports the products, it is not subject to output VAT on the export, and it can then claim part or all of the VAT on the purchase.

The approach to claiming zero rating in China is complex, and the administrative practices from province to province do differ. Zero rating is not fully self-assessed – certain documentation needs to be submitted to the tax authorities in order to be able to do so, and it is commonplace for claims to be scrutinized closely.



### Are there any special conditions which must be met for a favourable VAT treatment to apply to an export of goods?



There are very significant documentation requirements in order to treat a supply of goods from China to overseas as a zero rated export for VAT purposes.

As a guide only, exporters must register for a tax refund, including providing their business license and export approval documentation to the authorities. They must also submit a monthly Declaration Form for Tax Refund of Production Enterprises, together with supporting documentation. Certain types of exporters may have to comply with specific requirements applicable to their industry or activity.



## EXPORTS - SERVICES



### How are exports of services treated for VAT purposes?



Exports of services are generally exempt from VAT, except for the following services which potentially qualify for zero rating:

- licensed international transportation services provided by Chinese domestic carriers;
- aerospace transportation services provided by Chinese domestic carriers;
- production and publication of radio, film and television services for overseas entities;
- technology transfer provided to overseas entities;
- research and development services provided to overseas entities;
- energy management services provided to overseas entities, except where the object of the contract is in China;
- offshore outsourcing services;
- exported business process management services;
- software services, circuit design and testing services, information systems services, business; process management services provided to overseas entities.
- trademark and copyright transfer services provided to overseas entities;
- convention and exhibition services outside China;
- advertising services where the advertisement is released outside China;
- logistics and ancillary services provided to overseas entities;
- warehousing services provided to overseas entities where the warehouse is located outside China;
- leasing of tangible movable property where the property is outside China;
- cultural, education and healthcare and travel services provided outside China;
- postage services, delivery services and insurance for exported goods.

Many services which are exported are exempt from VAT, including:

- international transportation (typically provided by foreign airlines or carriers);
- voyage charter service;
- other unlicensed aerospace transportation services;
- broadcast of radio for overseas entities;
- technology advisory services;
- engineering and exploration services with the related project or mineral resources located outside of China;
- certification, verification and consulting services provided to overseas entities;
- telecommunications services provided by Chinese providers to overseas;



### Are there any special conditions which must be met in order for favourable VAT treatments to apply to an export of services?



Yes, there are a number of special conditions which must be satisfied, and the conditions do differ depending on the type of service, and certain provinces have their administrative procedures.

An underlying requirement in the rules for claiming VAT exemption is that they do not generally apply where the services relate to goods or real estate in China.

The approach to claiming VAT exemptions and zero rating in China is complex, and the administrative practices from province to province do differ. Generally, exemption or zero rating cannot be fully self-assessed – certain documentation needs to be submitted to the tax authorities in order to be able to do so, and it is commonplace for claims to be scrutinized closely.

## IMPORTS - GOODS

Q

How are goods dealt with on importation from a VAT perspective?

A

Imports of goods are subject to VAT. VAT is payable to Customs.

Overseas companies selling goods to consumers in China (e.g. through online sales) will typically need to appoint a customs agent or broker to handle the VAT payable on importation.

Q

How is VAT on imported goods recovered?

A

The recovery of VAT on importation is limited to general VAT taxpayers only, and is recovered through the completion of the VAT return. No special VAT invoice is required to claim the input VAT credit. Instead, the import payment VAT certificate is used to validate the input VAT claim.

Q

How and by whom is VAT paid on imports of goods?

A

VAT will not generally be payable on the purchase of goods from abroad, but rather, on importation into China.

VAT on imports is payable to Customs within 15 days of the issuance of a tax payment certificate by Customs.

Q

Are there any reliefs/exemptions from VAT for imported goods?

A

There are reliefs applicable to certain Customs special zones for certain temporary importations.



## IMPORTS - SERVICES

**Q** How are services which are brought in from abroad treated for VAT purposes?

**A** The general principle in China is that VAT applies if either the supplier or the recipient is in China.

If the supplier does not have a business establishment in China, then the recipient is required to pay the VAT on a withholding basis. The recipient in these circumstances will generally be entitled to an input VAT credit if they are registered as a general VAT taxpayer.

**Q** Who is responsible for paying any VAT due on imported services to the Tax Authorities?

**A** The party responsible for paying VAT on a withholding basis in respect of the importation of services is the recipient of the supply. However, both the overseas supplier and the local recipient may be jointly and severally liable for any underpayment of VAT.

**Q** How is VAT on imported services recovered?

**A** Where VAT withholding has been payable on the importation, then the recipient may claim an input VAT credit if they are registered as a general VAT taxpayer. The input VAT credit is claimed through the VAT return. No special VAT invoice is required. Instead, certain documentation evidencing the importation and payment of the withholding VAT must be obtained to validate the input VAT credit.

**Q** If the recipient of imported services in your country is obliged to withhold VAT on the service received from the overseas supplier, can the non-resident supplier recover this VAT?

**A** No. If the recipient of imported services is obliged to withhold VAT, it is only the recipient who can potentially recover this VAT by claiming an input VAT credit. The overseas supplier is unable to recover the VAT as there is no equivalent of the European 13th Directive VAT reclaim process available in China. It is generally recommended that the overseas supplier gross up the price for the VAT withholding.

**Q** Is a non-resident supplier of services required to register and charge local VAT in respect of supplies of services to consumers/non VAT registered customers in your country?

**A** Generally, no. However, they may be jointly and severally liable for underpayment of withholding VAT.



# Amount subject to VAT

## Q On what amount is VAT charged for domestic supplies

A VAT for domestic supplies is generally payable in respect of the gross selling price payable by the recipient, where the parties are dealing at arm's length. Amounts received from third parties, including subsidies, liquidated damages and similar amounts are potentially subject to VAT.

## Q Adjustments to the chargeable amount such as those required for discounts, related party transactions, supplies below market value etc.

A The value upon which VAT is assessed in China may be adjusted in a range of circumstances including:

- where the price is regarded as 'unjustifiably low';
- in practice, where the parties are not dealing at arm's length;
- where there is a 'deemed sale' (e.g. a gift).

## Q On what amount is VAT charged on imported goods

A VAT on imported goods is calculated based on the aggregate of the Customs dutiable value, together with any Customs duty and consumption tax payable.

Price discounts may reduce the value upon which VAT is payable, provided it is done in the same tax invoice, otherwise a 'red letter' invoice may need to be issued and this can be a difficult and time consuming process. There is generally limited flexibility in the types of discounts and rebates which may reduce the price upon which VAT is payable in China (as compared with many other countries), so careful attention to these issues is often required.

## Q On what amount is VAT charged for imported services

A The VAT for imported services is generally payable in respect of the gross selling price, where the parties are dealing at arm's length.

# Tax points



## Q

**When is VAT due on a supply of goods or services?**

## A

A VAT liability is generally triggered at the earlier of:

- The right to receive payment according to the contract/agreement or, in absence of a written contract, the date on which the service is completed/ownership of the goods is passed;
- The date in which the sales amount is received during or upon completion of the taxable act;
- The date on which either a commercial invoice or the VAT invoice is issued.

## Q

**Are there any special rules for the payment of VAT on imports of goods or services?**

## A

VAT on imports of goods is collected by Customs. VAT on the importation of services is collected from the local recipient in China on a withholding basis.

# Invoices

## Q In what circumstances is a business required to issue tax invoices?

**A** Special VAT invoices may only be issued by general VAT taxpayers and certain small-scale taxpayers in pilot industries, and even then, only through government issued and regulated anti-counterfeit electronic systems. Those special VAT invoices must contain certain information to be valid.

Small scale taxpayers except for certain pilot industries are unable to issue special VAT invoices themselves, however in some instances they can request their tax authority to issue special VAT invoices on their behalf so their customer can use it to claim an input VAT credit.

## Q Are suppliers required to issue invoices in respect of supplies of services to non-registered persons in your country where the supply is regarded as taking place in your country? If yes, can simplified invoices be issued or are all of the requirements listed in the next section below needed on the invoice?

**A** Special VAT invoices may only be issued to general VAT taxpayers; only special VAT invoices may be used to claim input VAT credits. The main exceptions to this are for import VAT on goods (where the import VAT payment certificate is used), or withholding VAT on imported services. For other taxpayers, general invoices may be issued. These 'general invoices' are also regulated as to form and content.

## Q If suppliers are obliged to issue invoices in respect of supplies of services to non-taxable persons in your country, what are the penalties for failing to do so?

**A** Suppliers are obliged to issue general invoices to all service recipients (including non-taxable persons in China) upon request, and non-compliance is potentially subject to a maximum penalty of RMB10,000.

## Q What do businesses have to show on a tax invoice?

**A** Special VAT invoices, known as “fapiaos”, may only be issued by general VAT taxpayers and certain small-scale taxpayers in pilot industries, and even then, only through government issued and regulated anti-counterfeit electronic systems and on numbered invoicing paper (the system is known as ‘the Golden Tax System’).

To be valid, special VAT invoices must also comply with the following:

- all items in the invoice must be completed consistently with the terms of what was actually supplied;
- letters in the VAT invoice must be legible and completed properly;
- the invoice must be issued at the time the VAT liability arises.





## Q Can simplified invoices be issued in your country?

**A** A simplified form of invoice, known as a 'general invoice' may be issued to taxpayers who are not general VAT taxpayers, e.g. small scale taxpayers.

## Q Is it possible to operate self-billing?

**A** No.

## Q Can businesses issue invoices electronically?

**A** Electronic invoicing is gradually being introduced in China by way of a pilot program and is managed through an online electronic invoice management system regulated by the tax authorities.

The majority of invoices in China are generally still issued in paper form using anti-counterfeit electronic systems (known as 'the Golden Tax System').

## Q Are there any specific requirements for self-billing?

**A** Not applicable.

## Q Can a business issue VAT invoices denominated in a foreign currency?

**A** No. A business can only issue special VAT invoices "fapiaos" in Chinese Yuan/Renminbi ("CNY" or "RMB").

## Q Are there any specific requirements for electronic invoicing?

**A** No, as electronic invoicing only eliminates the need for physical paper invoices, the data requirements remain the same for paper and electronic invoices.

# Record Keeping Requirements

Q

**How long must the records and invoices be retained?**

A

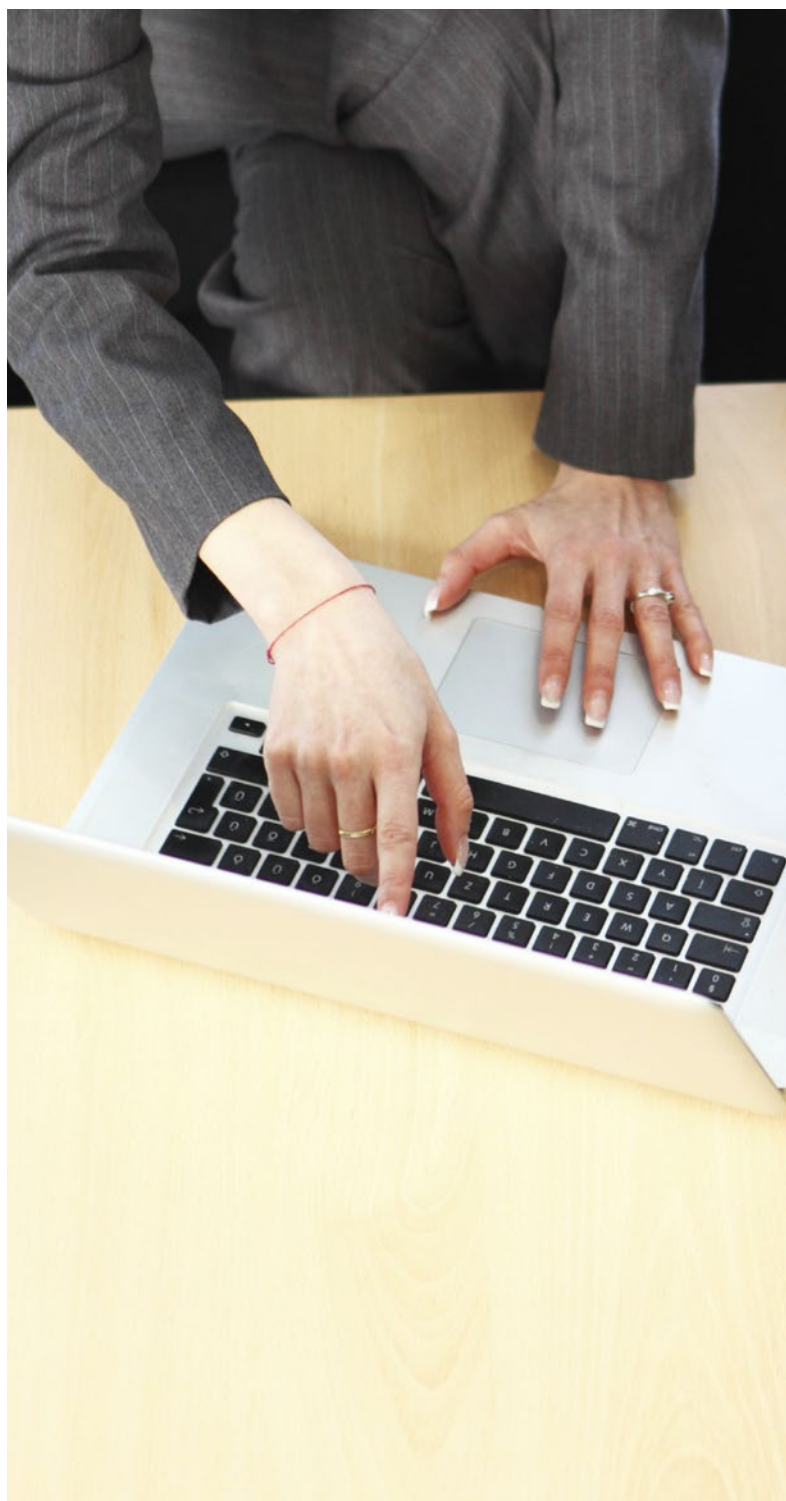
Account books, vouchers, statements, tax payment certificates and other tax records must be retained for 10 years.

Q

**Can the invoices be stored abroad?**

A

Generally no. In any event, invoices and accounts must be kept in Chinese language, but may be kept simultaneously in another language. Furthermore, the nature of the Golden Tax System is such that invoices can only be issued in China, and invoices received must be validated in China.



# Transfers of Business



**Q**

**Is there a relief from VAT for the sale of a business as a going concern?**

**A**

Yes, there is potentially relief available from VAT. However, the concession in China is not as broad as the going concern concession applicable in many other countries.

**Q**

**Is transfer of a business exempt from or out of the scope of VAT?**

**A**

Transfers of businesses which qualify for relief from VAT are regarded as not being subject to VAT (i.e. out of scope).

**Q**

**What are the main requirements for the relief?**

**A**

SAT Announcement<sup>13</sup> (January 2011) requires the taxpayer to have (1) transferred goods in a corporate reorganization which takes the form of a merger, de-merger, sale or exchange; and (2) transferred all or part of the tangible assets, and the related debt claims, liabilities and workforce.

These concessions are very general in their wording and can be difficult to apply in practice.



# Options to Tax



**Are there any options to tax transactions?**



Yes, there is an option to tax for VAT purposes - it is known as a tax exemption waiver. The tax exemption waiver is general in nature - that is, once waived it applies to all goods and services supplied by the entity, and to all of its customers for a minimum period of 3 years.

# Head Office and Branch transactions



**How are transactions between head office and branch treated?**



Transactions between a head office and its branch or between branches will generally be subject to VAT.

Upon approval by the Ministry of Finance and State Administration of Taxation a head office may file a consolidated VAT return and pay VAT on a consolidated basis for itself and branches located in the same province, thereby excluding inter-company transactions from VAT. However, consolidation is not generally available for transactions between a head office and its branches, or between branches, if located in different provinces.



# Bad Debts

**Q** Are businesses able to claim relief for bad debts?

**A** Generally, no bad debt relief is available for VAT purposes.

**Q** What evidence must a business hold in order to make a bad debt relief claim?

**A** Not applicable.

**Q** What conditions must a supplier fulfill in order to make a bad debt relief claim?

**A** Not applicable.

**Q** Is there any requirement to issue a notice to debtor when claiming a bad debt relief?

**A** Not applicable.

**Q** How does a business make a bad debt relief claim?

**A** Not applicable.

# Anti-Avoidance

**Q** Is there a general anti-avoidance provision under VAT law?

**A** There are limited anti avoidance provisions which deal with transactions at less than market value, or an abnormal loss is derived.

# Penalty Regime

## Q What is the penalty and interest regime like?

A The penalty and interest regime in China is designed to have a strong deterrent effect.

## Q What is the reassessment period?

A Generally, it is 3 years. However, it may be extended to 5 years where the amount of tax underpaid is greater than RMB 100,000. There is also no limitation in cases of tax evasion.

## Q What penalties can be imposed as a result of certain errors?

A There are several different types of penalty regimes applicable in China. They apply generally to all taxes, not just VAT. They include:

- a default fine applicable to all unpaid taxes, levied at a daily rate of 0.05 percent (equivalent to 18.25 percent p.a.);
- uniform fines of up to RMB 10,000, for failure to apply for, change or cancel tax registration within prescribed time limits, failure to establish or maintain accounting books, failure to maintain supporting documents, failure to submit accounting software to the tax authorities, failure to install tax-control facilities, failure to file tax returns or submit information required to accompany such returns;
- penalties ranging from 50 to 500 percent of the tax owed for tax evasion;
- there are also various criminal sanctions which may apply too, with a particular emphasis on VAT invoicing fraud.



# Tax authorities



## Tax audits



### How often do tax audits take place?

Audits take place regularly. They tend to be carried out in the form of annual tax inspections targeting specific industries or entities, self-inspections and random audits.

### Are there audits done electronically in your country (e-audit)? If so, what system is in use?

No, e-audits are not generally used.



## Advance rulings and decisions from the tax authority



### Is it possible to apply for formal or informal advance rulings from the (indirect) tax authority?

It is very uncommon. However, the Chinese tax authorities are in the process of implementing an advance tax rulings system, though it is not yet in widespread use.

The tax authorities in China rarely provide written advice – most interactions are provided by way of informal, verbal responses.

### Are rulings and decisions issued by the tax authorities publicly available in your country?

Not applicable.





# Miscellaneous

**Q In your country, are there unique specific indirect tax rules (regimes) that differ from standard indirect tax rules in other jurisdictions?**

**A** Yes, there are a significant number of special indirect tax rules in China which differ from standard indirect tax rules. Many of these rules arise from the fact that the indirect tax system is often used as a means of carrying out the government's economic and trade policies. The main differences include:

- there are multiple VAT rates applicable to different goods and services;
- no ability to claim refunds of excess input VAT credits (except for exporters of goods and certain services);
- registration and tax obligations arise at the branch level, not the legal entity level;
- foreign entities cannot generally register as VAT taxpayers;
- the invoicing system is highly regulated, both in terms of the supplier's obligations and the recipient's entitlement to input VAT credits;
- imports of services are subject to VAT on a withholding basis;
- exports of goods are "zero rated," but that does not necessarily lead to full recovery of input VAT incurred;
- the provision of goods for no consideration (e.g. free gifts) or for an unjustifiably low price will be a deemed sale for VAT purposes. The amount of VAT payable on the deemed sales is generally the average selling price. An example of this is where an entity gives 'free' promotional gifts to customers;

- in order to cancel or amend a special VAT invoice that has been issued, a red letter invoice must be approved by the tax authority, often referred to as a credit note in other countries. The process involves the taxpayer or customer going to the tax authority in person and submitting an application form to issue a red letter invoice. This can be cumbersome and time consuming.

**Q Are there indirect tax incentives available in your country (e.g. reduced rates, tax holidays)?**

**A** Generally no, however, the government from time-to-time does introduce various exemptions or concessions with a limited time span. Some large companies have historically negotiated to receive reduced VAT liabilities when setting up in a new province or district, but these arrangements are now occurring less commonly (other subsidies may be available instead).



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