China Tax Alert

Issue 8, March 2019

Chinese Government announces significant reduction to VAT rates as China enters new VAT legislative phase

Regulations discussed in this issue:

- Announcement by Premier Li Keqiang on 5 March 2019

Background

Chinese Premier Li Keqiang released a government work report as part of the ‘two sessions meeting’ on 5 March 2019 in which it announces that the current 16% and 10% VAT rates applicable to the supply of certain goods and services would be reduced to 13% and 9% respectively. This change will certainly bring welcome relief to businesses and consumers, and represents a significant step by the government to enhance economic activity in certain sectors, and reduce the overall tax burden impact.

The Chinese government has a long history of using its VAT system as a key tool in managing the economy, and this announcement is no exception. With this announcement, the government will have reduced the headline VAT rate by nearly 25% over the past 12 months – initially from 17% to 16% (with effect from 1 May 2018) and now from 16% to 13%. Once completed, China’s headline VAT rate will be significantly below the OECD average rate of 19%.

It is important to recognise that this significant rate reduction likely represents the first step only in a broader process of reforms of the Chinese VAT system. In particular, it is expected during 2019 and 2020 that the government will seek to reduce the number of VAT rates from three rates (being 6%, 9% and 13% as a result of this announcement), down to two rates. The government is also expected to upgrade the status of the VAT rules to formal legislation and implementation rules. The question which remains is whether (and to what extent) the government uses the VAT legislative process as an opportunity for further reforms, including in better aligning China’s VAT system with OECD principles.

In addition to the rate reduction, there will also be preferential treatments available, such as an increase to the credits to manufacturers and lifestyle related service providers, to ensure the tax burden of all the taxpayers is reduced. Details are expected to be issued by the policy makers shortly.

While at first glance this VAT rate reduction announcement may not seem challenging from a tax implementation perspective, as this Alert highlights, there are many issues for businesses to consider.

Date of effect

Premier Li's announcement does not mention a specific commencement date for the new rates to take effect, though he does reference it happening during 2019. Further detail in the form of a Circular should be expected shortly. Based on a similar experience in 2018, taxpayers may expect the rate reduction to take effect quickly, likely within the next few months. Consequently, taxpayers will need to take action to get ready for the new rates, both from a business and systems perspective.

Industries affected

The government's work report refers to the proposed new 13% rate applying to manufacturing, and it also refers to the 9% rate applying to transportation and construction activities. However, it does not mention whether these rate reductions will apply to all types of goods and services which are currently subject to the 16% and 10% rates.

If history is a guide here, it may reasonably be expected that the rate reductions will apply more broadly to all sectors currently paying VAT at these rates, as happened when a similar announcement was made back in March 2018 (when the 17% and 11% VAT rates were reduced to 16% and 10% respectively). This would seem to be necessary to achieve the government's objective of reducing (rather than expanding) the number of VAT rates in existence. Furthermore, it is difficult to see how such rate reductions could be ring-fenced to particular stages of economic activity, recognising also that if the objective is to stimulate economic activity amongst consumers, then any rate reduction needs to flow through to the retail sector. For these reasons, we anticipate that the rate reductions will apply more broadly.

On the assumption this is confirmed in a later announcement, then we would expect

Applies to:	**Current rate**	**New rate to take effect during 2019**
Sales of goods, importation of goods, leasing of tangible movable property; Repair and processing services	16%	13%
Transportation services, sales and leases of immovable property, basic telecommunications services, construction services, postal services, agricultural products and water and gas supplies	10%	9%

Financial services, modern services (including Research and Development and technical services, information technology services, cultural and creative services, logistics services, logistics and ancillary services, certification and consulting services), and lifestyle services (including cultural and sports services, education and healthcare, travel and entertainment, food and beverage, accommodation and citizens daily services)	6%	6%

The government's work report indicated there would be no change to the 6% VAT rate. However, it did refer to a desire to ensure a reduced tax burden impact. No specific details are provided at this stage. Whilst speculative, even industries paying output VAT at 6% should benefit in the form of price reductions for many of their inputs which will bear VAT at 13% and 9% - for example, in the rent they pay, in the equipment they use in their business, and other general overhead costs.

KPMG comments

While businesses and consumers will no doubt be pleased with the reduction to VAT rates, especially the reduction in the main 16% VAT rate to 13%, it is important to recognize that this is likely a first step in a longer-term process by which the government will reduce the number of VAT rates in operation from three rates, and in upgrading the status of the VAT rules to legislative form. While the 6% VAT rate was unchanged as a result of this announcement, it is perhaps too early to speculate whether the two rates will end up being 13% and 9%. Key to the success in implementing these rate changes for business is not only to focus on the impact on their outputs, but also to ensure the tax burden reduction flows through in the form of lower prices for their inputs. This will often require negotiation with suppliers.

It is important to recognize that a reduction in these two VAT rates of 16% and 10% to 13% and 9% respectively can still give rise to significant implications for businesses. Specifically, businesses need to consider the following issues, many of which will likely require further clarification pending the implementation rules and also from the tax officials. While the date of effect of the new rates is yet to be announced, even then, the precise impact will need to be carefully worked through:

Issue	Impact
Time of supply	Even when the date of effect of the new rates is announced. It will need to be determined whether it applies by reference to: (a) When the supply was made; (b) When the supplier was required to account for the output VAT; or (c) When the special VAT invoice was issued. This will need to be clarified. When similar changes have taken place in China, the general principle has been to apply the approach in paragraph (b).
Advance payments	Issues will arise as to whether advance payments received before the date of effect for the purchase of goods or services which take place on or after date of effect are subject to the new VAT rates or the current VAT rates. The travel industry is a primary example where customers may pre-book and pre-pay flight tickets well before travel occurring after the date of effect.
Deemed sales	Where a supplier buys goods before the date of effect (and claims an input VAT credit at 16%), an issue arises as to the applicable VAT rate under the deemed sales rules if those goods are given away on or after the date of effect.
Goods returns	Goods sold before the date of effect but returned on or after the date of effect will need to be issued with a red-letter invoice to cancel the supplier's output VAT and recipient's input VAT at 16%, not 13%. But when goods are returned and replaced, issues will arise in practice as to whether or not that is a new supply subject to 13% VAT taking place on or after the date of effect. Similarly, suppliers may anticipate some impact on demand as customers hold off purchasing major items until the date of effect to benefit from the lower VAT rates.

Contracting	Contracts which provide for VAT to be added to the price can readily adjusted to reflect the new VAT rates simply by adding say VAT at 13% (or 9%) instead of 16% (or 10%). However, contracts in which the price is inclusive of VAT may give rise to commercial uncertainties as to whether the reduction in rates needs to be passed on to the service recipient or not. This will often be a matter for negotiation between the parties. Given the potential for VAT rates to change again in the future, especially as a result of a move to a two rate structure, it does highlight how VAT-inclusive pricing can be problematic.
Pricing	Businesses with advertised or displayed pricing will likely need to consider changing their displays so as to pass on the tax savings to customers – otherwise it may detrimentally impact on their market competitiveness.
Annual price lists	It is common in certain industries for suppliers to agree or advertise prices on an annual basis at the commencement of each year, say by way of a standard rate card. Where this occurs, questions will arise as to whether those annual price lists should be revisited in light of the reduction in VAT rates.
Trading stock	Businesses may be in the position of having purchased trading stock on hand at 16% VAT, but then sell that stock on or after the date of effect with a lower 13% VAT rate.
Rebates and discounts	It is common that volume rebates and discounts are applied to the price of the next sale transaction or invoice amount, rather than the current sale (which would then necessitate the issuance of a 'red letter' invoice). If a rebate or discount is earned before the date of effect but then applied to a sale on or after the date of effect, the value of the 'credit' is effectively reduced.
Rounded pricing	It is common in certain industries for the prices of various products to be rounded to particular amounts, such as RMB1, or for pricing to be targeted at specific amounts such as RMB888. In these instances, a reduction in the VAT rate may not necessarily result in a price reduction and therefore increases the seller's margin. This will be a commercial decision to be made on a case-by-case basis.

Purchase of immovable property	Circular Caishui [2016] 36 provides that purchases of immovable property and construction costs for immovable properties are potentially eligible for a staged 60% input VAT credit in year 1 and a 40% input VAT credit in year 2. When the date of effect straddles this 2 year period, there is an issue as to whether the input VAT credit is calculated for year 2 at the 9% rate or at the original 10% rate. The latter would seem more appropriate.
Change in use of capital assets	Circular Caishui [2016] 36 also provides for adjustments to input VAT credits based on the change in use of capital assets – for example, where the use changes from a creditable to a non-creditable purpose (or vice versa). The question is whether those changes should be calculated at the new VAT rates or the originally applied VAT rates. Again, the latter would seem more appropriate.
Refund rates for exports of goods	While exports of goods are zero rated, there are different VAT refund rates applicable to the inputs, depending upon the HS code of the goods being exported. The current VAT refund rates are 0%, 6%, 10%, 13% and 16%. These refund rates will presumably need to be adjusted in light of the announcement.
Systems changes	Businesses will need to ensure they have additional tax codes in their systems to recognize both output tax and input tax at 13% and 9%.

Contact us

China

Lewis Lu
Head of Tax
KPMG China
E: lewis.lu@kpmg.com
T: +86 (21) 2212 3421

National Leader and Hong Kong

Lachlan Wolfers
Head of Indirect Tax
KPMG China
E: lachlan.wolfers@kpmg.com
T: +852 2685 7791

Northern Region

Fiona Yu
Tax Director
KPMG China
E: fiona.yu@kpmg.com
T: +86 (10) 8508 7663

Eastern and Western Region

Michael Li
Tax Partner
KPMG China
E:michael.y.li@kpmg.com
T: +86 (21) 2212 3463

Southern Region

Grace Luo
Tax Partner
KPMG China
E: grace.luo@kpmg.com
T: +86 (20) 3813 8609

China Tax Centre, United States

Shirley Shen
Leader, China Tax Centre
KPMG United States
E: yinghuashen1@kpmg.com
T: +1 (408) 367 6088

KPMG

Contact Us

For any enquiries, please send to our public mailbox: taxenquiry@kpmg.com or contact our partners/directors in each China/HK offices.

Khoonming Ho
Head of Tax,
KPMG Asia Pacific
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Lewis Lu
Head of Tax,
KPMG China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Beijing/Shenyang/Qingdao
Vincent Pang
Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Tianjin
Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Shanghai/Nanjing/Chengdu
Anthony Chau
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Hangzhou
John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Guangzhou
Lilly Li
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen
Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Shenzhen
Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong
Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern Region

Vincent Pang
Head of Tax,
Northern Region
Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Conrad TURLEY
Tel. +86 (10) 8508 7513
conrad.turley@kpmg.com

Yali Chen
Tel. +86 (10) 8508 3036
yali.chen@kpmg.com

Milano Fang
Tel. +86 (532) 8907 1724
milano.fang@kpmg.com

Tony Feng
Tel. +86 (10) 8508 7531
tony.feng@kpmg.com

Flora Fan
Tel. +86 (10) 8508 7611
flora.fan@kpmg.com

John Gu
Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Rachel Guan
Tel. +86 (10) 8508 7613
rachel.guan@kpmg.com

Helen Han
Tel. +86 (10) 8508 7627
h.han@kpmg.com

Michael Wong
Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Henry Kim
Tel. +86 (10) 8508 5000
henry.kim@kpmg.com

Ruby Jiang
Tel. +86 (10) 8553 3680
ruby.jiang@kpmg.com

David Ling
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Lisa Li
Tel. +86 (10) 8508 7638
lisa.h.li@kpmg.com

Lucia Liu
Tel. +86 (10) 8508 7570
lucia.jj.liu@kpmg.com

Shirley Li
Tel. +86 (10) 8553 3758
shirley.s.li@kpmg.com

Alan O'Connor
Tel. +86 (10) 8508 7521
alan.oconnor@kpmg.com

Shirley Shen
Tel. +86 (10) 8508 7586
yinghua.shen@kpmg.com

Joseph Tam
Tel. +86 (10) 8508 7605
laiyiu.tam@kpmg.com

Joyce Tan
Tel. +86 (10) 8508 7666
joyce.tan@kpmg.com

Christopher Xing
Tel. +86 (10) 8508 7072
christopher.xing@kpmg.com

Kensuke MATSUDA
Tel. +86 (10) 8508 7034
kensuke.matsuda@kpmg.com

Irene Yan
Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Adams Yuan
Tel. +86 (10) 8508 7596
adams.yuan@kpmg.com

Jessie Zhang
Tel. +86 (10) 8508 7625
jessie.j.zhang@kpmg.com

Sheila Zhang
Tel: +86 (10) 8508 7507
sheila.zhang@kpmg.com

Tracey Zhang
Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Vivian Zhou
Tel. +86 (10) 8508 3360
v.zhou@kpmg.com

Carol Cheng
Tel. +86 (10) 8508 7644
carol.y.cheng@kpmg.com

Ally Mi
Tel. +86 (10) 8508 7583
ally.mi@kpmg.com

Kenny Wang
Tel. +86 (10) 8508 7655
kenny.wang@kpmg.com

Fiona Yu
Tel. +86 (10) 8508 7663
fiona.yu@kpmg.com

Lily Zhang
Tel. +86 (10) 8508 7545
lily.l.zhang@kpmg.com

Eric Zhao
Tel. +86 (10) 8508 7493
eric.zhao@kpmg.com

Laura Xu
Tel. +86 (532) 8907 1731
laura.xu@kpmg.com

Eastern and Western Region

Anthony Chau
Head of Tax,
Eastern & Western Region
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Cheng Chi
Tel. +86 (21) 2212 3433
cheng.chi@kpmg.com

Johnny Deng
Tel. +86 (21) 2212 3457
johnny.deng@kpmg.com

Cheng Dong
Tel. +86 (21) 2212 3410
cheng.dong@kpmg.com

Chris Ge
Tel. +86 (21) 2212 3083
chris.ge@kpmg.com

Chris Ho
Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Henry Wong
Tel. +86 (21) 2212 3380
henry.wong@kpmg.com

Jason Jiang
Tel. +86 (21) 2212 3527
jason.jt.jiang@kpmg.com

Sunny Leung
Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Michael Li
Tel. +86 (21) 2212 3463
michael.y.li@kpmg.com

Karen Lin
Tel. +86 (21) 2212 4169
karen.w.lin@kpmg.com

Benjamin Lu
Tel. +86 (21) 2212 3462
benjamin.lu@kpmg.com

Christopher Mak
Tel. +86 (21) 2212 3409
christopher.mak@kpmg.com

Naoko Hirasawa
Tel. +86 (21) 2212 3098
naoko.hirasawa@kpmg.com

Ruqiang Pan
Tel. +86 (21) 2212 3118
ruqiang.pan@kpmg.com

Amy Rao
Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Wayne Tan
Tel. +86 (28) 8673 3915
wayne.tan@kpmg.com

Tanya Tang
Tel. +86 (25) 8691 2850
tanya.tang@kpmg.com

Rachel Tao
Tel. +86 (21) 2212 3473
rachel.tao@kpmg.com

Janet Wang
Tel. +86 (21) 2212 3302
janet.z.wang@kpmg.com

John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Mimi Wang
Tel. +86 (21) 2212 3250
mimi.wang@kpmg.com

Jennifer Weng
Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

Grace Xie
Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Bruce Xu
Tel. +86 (21) 2212 3396
bruce.xu@kpmg.com

Jie Xu
Tel. +86 (21) 2212 3678
jie.xu@kpmg.com

Robert Xu
Tel. +86 (21) 2212 3124
robert.xu@kpmg.com

Jason Yu
Tel. +86 (21) 2212 3316
jjm.yu@kpmg.com

William Zhang
Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

Hanson Zhou
Tel. +86 (21) 2212 3318
hanson.zhou@kpmg.com

Michelle Zhou
Tel. +86 (21) 2212 3458
michelle.b.zhou@kpmg.com

Eric Zhang
Tel. +86 (21) 2212 3398
eric.z.zhang@kpmg.com

Kevin Zhu
Tel. +86 (21) 2212 3346
kevin.x.zhu@kpmg.com

Leon Shao
Tel. +86 (21) 2212 3622
leon.shao@kpmg.com

Joyce Wang
Tel. +86 (21) 2212 3387
joyce.t.wang@kpmg.com

Robin Xiao
Tel. +86 (21) 2212 3273
robin.xiao@kpmg.com

Ellen Yan
Tel. +86 (21) 2212 3484
ellen.yan@kpmg.com

Tim Zeng
Tel. +86 (21) 2212 3759
tim.zeng@kpmg.com

Southern Region

Lilly Li
Head of Tax,
Southern Region
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Vivian Chen
Tel. +86 (755) 2547 1198
vivian.w.chen@kpmg.com

Nicole Cao
Tel. +86 (20) 3813 8619
nicole.cao@kpmg.com

Felix Feng
Tel. +86 (20) 3813 7060
Felix.feng@kpmg.com

Ricky Gu
Tel. +86 (20) 3813 8620
ricky.gu@kpmg.com

Fiona He
Tel. +86 (20) 3813 8623
fiona.he@kpmg.com

Aileen Jiang
Tel. +86 (755) 2547 1163
aileen.jiang@kpmg.com

Cloris Li
Tel. +86 (20) 3813 8829
cloris.li@kpmg.com

Jean Li
Tel. +86 (755) 2547 1128
jean.j.li@kpmg.com

Sisi Li
Tel. +86 (20) 3813 8887
sisi.li@kpmg.com

Mabel Li
Tel. +86 (755) 2547 1164
mabel.li@kpmg.com

Kelly Liao
Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Patrick Lu
Tel. +86 (755) 2547 1187
patrick.c.lu@kpmg.com

Grace Luo
Tel. +86 (20) 3813 8609
grace.luo@kpmg.com

Ling Lin
Tel. +86 (755) 2547 1170
ling.lin@kpmg.com

Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Chris Xiao
Tel. +86 (20) 3813 8630
chris.xiao@kpmg.com

Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Koko Tang
Tel. +86 (755) 2547 4180
koko.tang@kpmg.com

Bin Yang
Tel. +86 (20) 3813 8605
bin.yang@kpmg.com

Lixin Zeng
Tel. +86 (20) 3813 8812
lixin.zeng@kpmg.com

Nicole Zhang
Tel. +86 (20) 3813 8644
nicole.ll.zhang@kpmg.com

Bruce Liu
Tel. +86 (20) 3813 8636
bruce.liu@kpmg.com

Sophie Lu
Tel. +86 (20) 2547 1141
ss.lu@kpmg.com

Fiona Wu
Tel. +86 (20) 3813 8606
fiona.wu@kpmg.com

Philip Xia
Tel. +86 (20) 3813 8674
philip.xia@kpmg.com

Hong Kong

Curtis Ng
Head of Tax, Hong Kong
Tel. +852 2143 8709
curtis.ng@kpmg.com

Ayesha M. Lau
Tel. +852 2826 7165
ayesha.lau@kpmg.com

Darren Bowdern
Tel. +852 2826 7166
darren.bowdern@kpmg.com

Yvette Chan
Tel. +852 2847 5108
yvette.chan@kpmg.com

Lu Chen
Tel. +852 2143 8777
lu.l.chen@kpmg.com

Patrick Cheung
Tel. +852 3927 4602
patrick.p.cheung@kpmg.com

Wade Wagatsuma
Tel. +852 2685 7806
wade.wagatsuma@kpmg.com

Natalie To
Tel. +852 2143 8509
natalie.to@kpmg.com

Elizabeth DE LA CRUZ
Tel. +852 2826 8071
elizabeth.delacruz@kpmg.com

Matthew Fenwick
Tel. +852 2143 8761
matthew.fenwick@kpmg.com

Sandy Fung
Tel. +852 2143 8821
sandy.fung@kpmg.com

Charles Kinsley
Tel. +852 2826 8070
charles.kinsley@kpmg.com

Stanley Ho
Tel. +852 2826 7296
stanley.ho@kpmg.com

Becky Wong
Tel. +852 2978 8271
becky.wong@kpmg.com

Barbara Forrest
Tel. +852 2978 8941
barbara.forrest@kpmg.com

Kate Lai
Tel. +852 2978 8942
kate.lai@kpmg.com

Travis Lee
Tel. +852 2143 8524
travis.lee@kpmg.com

Irene Lee
Tel. +852 2685 7372
irene.lee@kpmg.com

Alice Leung
Tel. +852 2143 8711
alice.leung@kpmg.com

Ivor Morris
Tel. +852 2847 5092
ivor.morris@kpmg.com

Benjamin Pong
Tel. +852 2143 8525
benjamin.pong@kpmg.com

Malcolm Prebble
Tel. +852 2684 7472
malcolm.j.prebble@kpmg.com

David Siew
Tel. +852 2143 8785
david.siew@kpmg.com

Murray Sarelius
Tel. +852 3927 5671
murray.sarelius@kpmg.com

John Timpany
Tel. +852 2143 8790
john.timpany@kpmg.com

Lachlan Wolfers
Tel. +852 2685 7791
lachlan.wolfers@kpmg.com

Daniel Hui
Tel. +852 2685 7815
daniel.hui@kpmg.com

Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Adam Zhong
Tel. +852 2685 7559
adam.zhong@kpmg.com

Eva Chow
Tel. +852 2685 7454
eva.chow@kpmg.com

Alexander ZEGERS
Tel. +852 2143 8796
zegers.alexander@kpmg.com

Gabriel Ho
Tel. +852 3927 5570
gabriel.ho@kpmg.com

Vivian Tu
Tel. +852 2913 2578
vivian.l.tu@kpmg.com

kpmg.com/cn