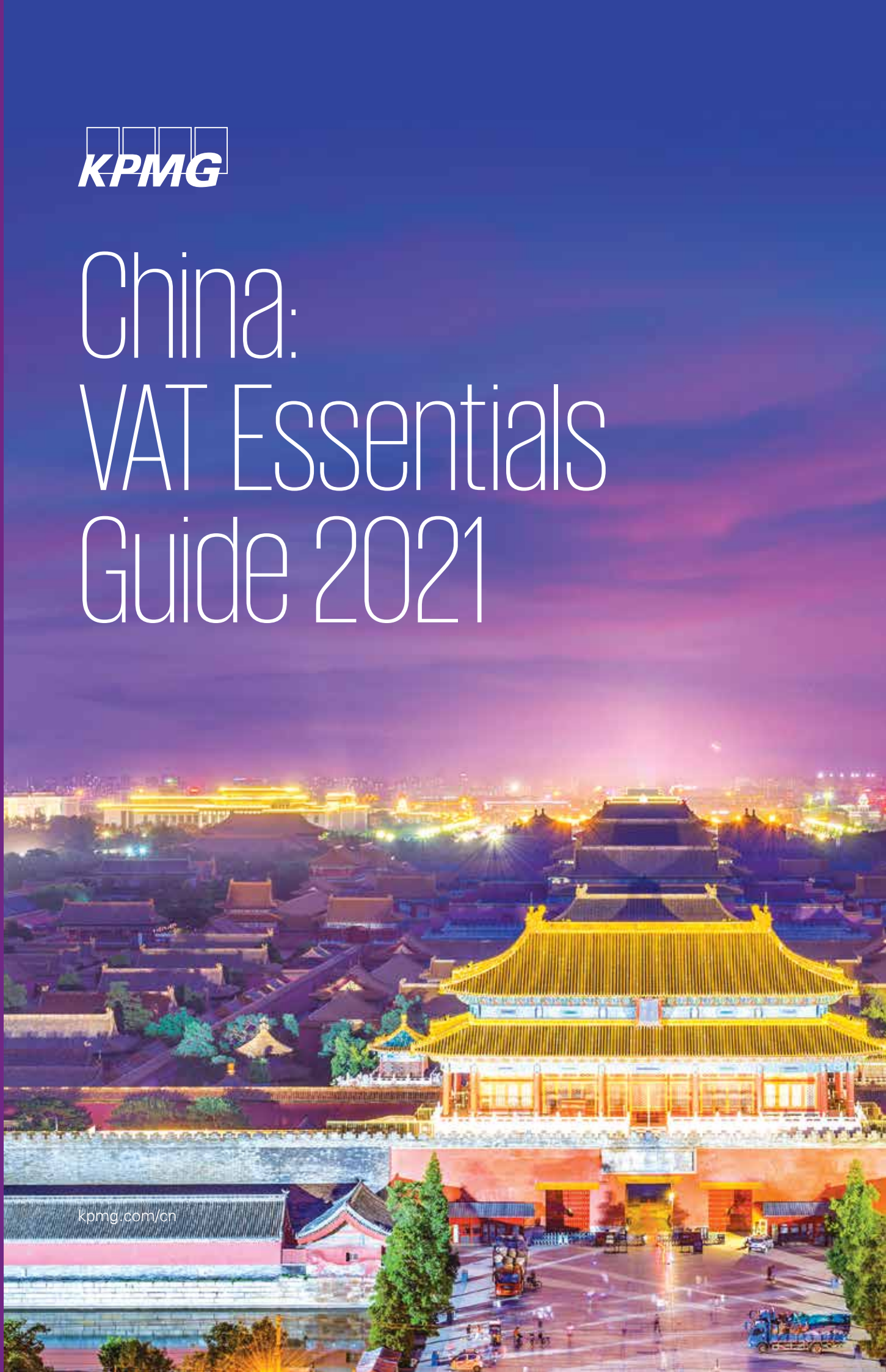




# China: VAT Essentials Guide 2021

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# Introduction



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Welcome to the 2021 KPMG China edition of the China VAT essentials guide!

The China VAT essentials guide aims to provide our clients (and potential clients) with key information about China's VAT system (in English language), with the aim of demystifying and explaining many of its core principles. We do this intentionally in a way which seeks to draw the reader's attention to key issues impacting on multinationals doing business in, or with, China. Importantly, it must be recognised that what we set out in our China VAT essentials guide typically deals with the most common use cases – what can make China's VAT system challenging is the myriad of exceptions which can apply based on specific or local policies and practices.

Ever since we first started producing a China VAT essentials guide, we have noticed continual steps being taken which bring about greater alignment between China's VAT system and the VAT/GST systems in common usage around the world. For example, our 2021 version highlights important developments in the opening up of VAT refunds more broadly, and not simply limiting refunds to exporters (as was the case previously).

Also on the horizon is a nationwide rollout of electronic invoicing, which initially began with B2C transactions, before being piloted for new businesses with B2B transactions in early 2021. This development will accelerate the shift away from paper based invoicing, and is expected to herald both cost saving opportunities for businesses through a reduction in manual invoicing processes, and also the opening up of the possibility for businesses to consider outsourcing this function (together with their VAT return filing processes).

Interestingly, as we reflect on these developments, it is also noteworthy that China has retained certain unique features of its VAT system, which differentiate it from many major VAT/GST systems used in other parts of the world. By way of example:

1. China maintains a multiple VAT rate system – 3 percent, 6 percent, 9 percent and 13 percent - though the prospect of further rationalisation of these rates cannot be discounted in the near future;
2. Most exported services are exempted from VAT (not zero rated). While exported goods qualify for zero rating, the refund rate applicable to the inputs (e.g. raw materials) used in the production of those goods may be less than the VAT incurred (i.e. there is an embedded cost);

3. Non-residents without a presence in China are unable to register for VAT purposes, and therefore similarly unable to claim a refund of any VAT incurred on inputs;
4. A VAT withholding system applies (instead of a reverse charge) where services are provided by an overseas party to a business or individual (or an agent) in China;
5. Bad debts are generally ineligible for relief, meaning that a liability to pay output VAT can still arise even though the corresponding fee is never received from the customer;
6. Gifts and other products or services given away may be liable to output VAT, even where the parties are not associated;
7. China is yet to implement specific measures to require non-residents to account for VAT on digital services provided to consumers in China, though in reality due to regulatory, language and consumer preferences, there is a greater level of usage of domestic digital providers as compared to many other countries (meaning that such rules are not as necessary);
8. Financial services are subject to VAT as the default position, with any exemptions or exclusions being relatively narrowly applied;
9. The concept of carrying on a business (or similar) as a prerequisite to being brought within the VAT regime does not exist in China. Instead, liability to VAT is generally dependent on meeting a turnover threshold. This means that certain C2C transactions involving real estate may be within the VAT net in China.

It will be fascinating to review this list in a few years time and identify what (if any) further developments have been made in terms of alignment between China's VAT system and international norms. Interestingly though, what we have also witnessed is that aspects of China's VAT system seem to be taking hold in other parts of the world. The most prominent example of this is the growth in regulated invoicing systems, similar to China's Golden Tax System, which seem to have a foothold in places like Indonesia, India, Korea, Vietnam, Taiwan.

In 2021 and 2022 it is expected that China will be upgrading the status of its current VAT rules based system into a formally enacted law, and it remains to be seen the extent to which this will be accompanied by further substantive changes to the VAT system.

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## Hong Kong (SAR), China

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# Significant indirect tax developments at a glance



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



China's VAT system is amongst the broadest based systems amongst around 170 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.

Over the past few years, the Chinese government has gradually reduced its VAT rates. The Chinese government has also released a number of VAT policies and implementation rules which significantly progress China's efforts to better align its VAT rules with OECD principles, including:

- Starting from 1 April 2019, the VAT refund mechanism in respect of excess input VAT credits has been opened up to all businesses;
- Starting from 1 April 2019, businesses are eligible to claim input VAT credits for transportation services taken by their employees in the course of their work.



**Are any significant changes expected over the near future?**



It is expected that in the next few years China will enact formal VAT legislation. The current approach reflects the fact that since 2016 the VAT has been operating in accordance with a series of pilot rules for services, and regulations for goods.

The draft VAT Law went through a public consultation stage in November and December 2019, and a revised version based on the consultation comments was submitted for the State Council's review in June 2020. However, it is still pending approval by the State Council and the National People's Congress.

It is also expected that electronic invoicing will be implemented in respect of special VAT invoices (i.e. for B2B transactions where a credit can be claimed). Prior to 2020, electronic invoicing has only been available for general VAT invoices (i.e. for B2C transactions). In 2020, the electronic special VAT invoices pilot program has been trialed in a few cities. Starting from 21 January 2021, the electronic special VAT invoices pilot program will expand to newly registered taxpayers nationwide. Later in 2021, it is expected to be applied to all taxpayers.

Similar to the VAT legislation, reforms to the Consumption Tax (CT) legislation is currently underway and is anticipated to be finalized in the next few years. Specifically, the draft CT Law went through a public consultation stage in December 2019 and January 2020, and it is pending approval by the National People's Congress. A key change proposed by the CT consultation paper is to shift the taxing point from "production/import" to the "wholesale/retail" stage, which is likely to result in a significant increase in the number of taxpayers liable to CT. Rate adjustments will also be needed, otherwise the imposition of CT at a later stage will result in higher CT liabilities.

# 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").

VAT can apply to the sale and importation of goods in or to China, and the provision of all services in or to China. VAT also applies to the provision of services from China to overseas except where exemption or zero-rating applies. 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 currently applies to the manufacture, processing, importation and selling of certain types of goods, principally luxury items.

There are also local taxes and surcharges that are calculated based on the payable amounts of indirect taxes (VAT and CT). These local taxes and surcharges vary slightly by location in China, and are not creditable taxes.

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 Macao. 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 changes 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 13 percent for general VAT taxpayers from April 2019 onwards. The standard rate of 13 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 percent – 'small-scale taxpayers,' being those without sophisticated business, accounting and auditing systems and whose annual turnover is below RMB 5 million. These small scale taxpayers pay output VAT at 3 percent, but cannot claim input VAT credits on purchases. The 3 percent 'simplified VAT rate' also applies to certain construction services and revenue from asset management products (meaning that output VAT is paid at 3 percent, but no input VAT credits can be claimed on purchases).
- 5 percent - this is the simplified VAT rate applicable to certain real estate transactions, and is effectively a transitional measure applied to certain real estate held as at 1 May 2016 (being the time when VAT was expanded to the real estate sector).

- 6 percent – ‘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).
- 9 percent – 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 April 2019, the 9 percent 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 real estate specific taxes, motor vehicle taxes and mining specific taxes
- various local taxes and surcharges, such as the Urban Maintenance & Construction Tax and Education Levy



# 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 taxpayers".

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 RMB 5,000-20,000 per month of sales, or RMB 300-500 per transaction in the majority of provinces in China.

"Small scale taxpayers" are those with annual sales turnover of not more than RMB 5 million. It is possible for taxpayers that would otherwise be "small scale taxpayers" to voluntarily register as "general VAT taxpayers" if they demonstrate the business is able to provide accurate tax information.

Taxpayers whose annual taxable revenue exceeds RMB 5 million must register as general VAT taxpayers. While the general position is that once registered as a general VAT taxpayer the business cannot reverse its VAT registration back to a small scale taxpayer, there was some exceptional circumstances. For example:

- At the time when the threshold of general VAT taxpayers was unified to RMB 5 million (as compared to a range from RMB 500,000 to 5 million varying across industries), a 'transition period' from May to December 2018 was allowed for some qualified general VAT taxpayers to opt for reversing its VAT registration from general VAT taxpayers to small scale taxpayers.
- A similar 'transition period' has been implemented again from January 2019 to December 2019, and from May 2020 to December 2020.

These 'transition periods' are granted by specific tax circulars and are time limited. There is no guarantee whether this will continue to be effective after December 2020. As of the date of preparing this guide, we are not aware of any tax circular that extends the deadline.

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); or
- VAT is payable in the usual way with input tax credits generally available for business purchases.

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

	General VAT taxpayer	Small scale taxpayer
<b>Output VAT</b>	Yes, at various rates depending on the types of supplies made, ranging from 6 percent to 13 percent	3 percent
<b>Input VAT credits</b>	Yes, can generally claim for business purchases	No, cannot claim
<b>Issue special VAT invoices</b>	Yes	Yes. In the past the small scale taxpayers can only request their tax authority to issue special VAT invoices on their behalf, however such restriction has been relaxed and therefore small scale taxpayers is opt to issue special VAT invoices directly.
<b>Receive special VAT invoices</b>	Yes	No



## 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 there 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.



## 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. If a small scale taxpayer derives taxable revenue whose accumulated amount for the consecutive 12 months meets or exceeds RMB 5million, it is required to register as a general VAT taxpayer within 15 days after the filing due date of the period in which the taxpayer meets the above requirements/thresholds. If it does not register as a general taxpayer in time, the tax authority would typically issue a notice to request rectification of its VAT registration status within specified time limit.

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



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



No.



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



Not applicable.



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



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.

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.



**Is call-off stock implemented in your country?**



No.



**Is consignment stock implemented in your country?**



No.



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



No, see above.



**Consignment stock simplification**



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 3 percent simplified VAT rate applicable to the sale of goods by consignment shops.



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



Not applicable.



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



The supply of installation and assembly services, in addition to the supply of goods, would ordinarily all be subject to 13 percent VAT, though there may be situations where the installation or assembly service could be structured as a separate service which instead attracts a 6 percent VAT rate.

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.



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



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 account for transactions separately, particularly where they operate in different provinces. Transactions between a head office and a branch or between branches may even be subject to VAT.

For the airline and railway transportation industries, consolidated filing may be available on a national/legal entity level. For the telecommunications and certain financial services, consolidated filing at a provincial level is generally permitted. Further, for some specific industries (e.g. certain merchandise retailers, service station operators) a head office and its branches in the same province may be eligible to report on a consolidated basis. Even still, such branches may be required to make separate VAT payments.

Branches (which includes stores, factories or any other place of business) in the same tax district may apply for consolidated filing. In general, approval is required for VAT consolidated filing.

## 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. Taxpayers in certain industries (e.g. banks, financing companies, trust investment companies, credit cooperatives) and small scale taxpayers 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 the taxable revenue arises. Taxpayers are not entitled to switch methods within the course of a year.



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



Yes. For general VAT Taxpayers, the main VAT filing form and the four 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 the current period;
- Appendix 2 – Details of input VAT for the current period;
- Appendix 3 – Details of deductible items for taxable services, immovable property and intangible assets;
- Appendix 4 – Details of prepaid and reduced VAT;
- Record form for tax reduction and exemption;

For Small-scale taxpayers, there is also a simplified set of VAT returns listed as following:

- VAT filing return (main form)
- Appendix (that elaborates how some figures on the main form are computed)

It is possible that taxpayers may be requested to file additional forms subject to local practice in the place where the taxpayers are located, but the requirement for submitting the aforementioned forms should apply broadly to General VAT Taxpayers and Small-scale taxpayers respectively.

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. Nowadays those returns are effectively completed automatically as part of the VAT filing process.

# VAT Recovery

## Q Can a business recover VAT if it is not registered

**A** **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.

### **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.

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

**A** No.

## Q What are the general conditions for claiming an input VAT credit?

**A** 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.

## 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, entertainment and residential daily 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. Specifically, refunds of excess input VAT credits used in exporting are restricted by reference to the particular "refund rates" which apply and these are determined by reference to the HS code of the goods being exported. As such, there may be a leakage in export VAT recovery.



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



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 is subject to VAT at 9 percent. Starting from 1 April 2019, businesses are eligible to claim input VAT credits for domestic flights, rail and road transportation services. The new rules also allow input VAT credits to be claimed using alternative forms of evidence such as VAT electronic general invoices, travel itineraries, railway tickets and other similar travel related documentation that have the passenger ID information, in addition to VAT special invoices. Therefore, businesses are generally eligible to claim input VAT credits for their employees’ domestic air business travel by obtaining travel evidence such as VAT electronic general invoices and travel itineraries.

### 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 is generally subject to 9 percent VAT. Businesses are generally eligible to claim input VAT credits for their employees’ rail business travel by obtaining travel documentation such as railway tickets.

### Taxi Fares

Taxi services are subject to 6 percent VAT from 1 May 2016 as lifestyle services. The rate of VAT is 6 percent if the taxi provider is registered as a general VAT taxpayer, or 3 percent if it is a small scale taxpayer. Businesses are generally eligible to claim input VAT credits for their employees’ business travel by VAT electronic general invoices.

### Car Rental

Car rental is subject to 13 percent VAT. Where 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.

### 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 is subject to 9 percent VAT. Businesses are generally not eligible to claim input VAT credits for staff welfare and private consumption related costs. 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.

### Hotels

Accommodation services are subject to 6 percent as lifestyle services. 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 are subject to 6 percent VAT as lifestyle service. The VAT rules specifically disallow input VAT credits for all F&B services.

### Telephone Calls

Telecommunications services are also subject to VAT. An employee’s telephone calls from 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.



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



Yes.

For fixed assets, immovable property and intangibles, 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 purchases other than the above assets used to derive VAT exempt revenue, 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.



## 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?



The general rule is that excess input VAT credits are allowed to be carried forward potentially indefinitely until the time it can be utilized to offset against output VAT. This is now subject to situations where a refund can be claimed.

Historically, refunds of excess input VAT had been generally restricted to 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.

However, since 1 April 2019, essentially all taxpayers can apply for a refund of excess input VAT, if all of the below conditions are met:

- The excess input VAT must be greater than zero for 6 consecutive months (or two consecutive quarters, for those who file on a quarterly basis), starting from April 2019. Excess input VAT refers to the situation where the current month's unutilized input VAT credit balance exceeds that of the unutilized balance at 31 March 2019;
- The input VAT balance must not be less than RMB 500,000 over that same 6-month period, when compared to the balance as at 31 March 2019;
- The taxpayer's tax credit rating must either be classified as "A" grade or "B" grade (which effectively denotes them as being highly compliant taxpayers);
- The taxpayer should not have been involved in any cases of fraudulent refund claims, false issuance of special VAT invoices or tax evasion penalties (no more than twice), within the 3-year period preceding the applicable tax refund;
- The taxpayer has not benefited from the "VAT refund upon collection" and "VAT refund after collection" policies, which are some other VAT preferential policies in China, from 1 April 2019;
- If a refund claim has been made, the subsequent claim for refund must happen at least 6 months after the previous claim.

Where all of the above conditions are satisfied, the taxpayer will be entitled to claim a refund of at most 60 percent of the excess input VAT, or a full refund for a taxpayer that is engaged in certain sectors (such as manufacturing and sale of non-metallic mineral products, universal equipment, special equipment and computers, communications and other electronic equipment).

It is important to note that the above refund mechanism applies only to excess input VAT arising on or after 1 April 2019. In other words, any existing excess input VAT balance arising prior to 1 April 2019 remains non-refundable (and can only be carried forward). It is expected that the scope of refundable excess input VAT will be expanded to cover balances arising from prior periods but there appears to be no tentative schedule.



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



Yes. From April 2019 to December 2021, certain taxpayers are entitled to a 'super-deduction' of input VAT credits. Those qualified taxpayers are allowed to calculate the VAT payable by deducting 110 percent/115 percent of its input VAT against the output VAT. In other words, an additional 10 percent/15 percent of the original VAT amounts shown on the underlying invoices.

Specifically, taxpayers who are engaged in the business of certain prescribed services (including postal services, telecommunications services, modern services and lifestyle services) and the revenue derived from these services exceeds 50 percent of the taxpayers' total revenue, are able to deduct 110 percent of its input VAT against its output VAT. Furthermore, from October 2019 to December 2021, taxpayers providing lifestyle services are allowed to deduct 115 percent of its input VAT against its output VAT.

# 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?



The following services 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.

The following services are potentially 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;
- 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.

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. Recordal filing is required for VAT exemption while zero rating needs to be pre-approved by the tax authorities with close scrutinization.



### 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.

## IMPORTS - GOODS



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



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 Chinese customs agent or broker to handle the VAT payable on importation.



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



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.



**How is VAT on imported goods recovered?**



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.



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



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



**Is there a low value threshold below which the importation of goods is not subject to VAT?**



Where goods, not purchased through the specific cross-border e-commerce importation scheme, are delivered to an individual customer through the post and the tax amount is equal to or below RMB 50, the Customs authority will not levy customs duty or import VAT on that parcel.

Retail goods purchased through the cross-border e-commerce importation scheme enjoy favorable customs duty, VAT and consumption tax treatments. The customs duty rate is 0% and the import VAT and consumption tax is calculated based on 70% of the statutory tax payable (i.e. a 30% discount is given). This is subject to certain thresholds which apply at a transaction level (RMB 5,000 per transaction) and an annual threshold per person (RMB 26,000), and apply on a temporary basis.



## IMPORTS - SERVICES



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



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.



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



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.



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



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.



**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?**



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



**Are there specific VAT rules for cross-border supplies of digital services by non-resident suppliers to customers located in China?**



There are no specific VAT rules for cross border supplies of e-services by non-resident suppliers to customers located in China. Instead, similar to the position for all services supplied by non-resident suppliers to customers in China, VAT withholding will apply. This means that the customer located in China is required to withhold VAT at the applicable rate from the payment they make. Technically these rules apply to both individual consumers and businesses in China.



# Amount subject to VAT



Q

**On what amount is VAT charged for domestic supplies?**

A

VAT for domestic supplies is generally payable on 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).

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 may trigger additional tax compliance issues. 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 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.

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

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 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 can only be issued through government issued and regulated anti-counterfeit electronic systems (known as 'the Golden Tax System'). Those special VAT invoices must contain certain information to be valid.

In general, small scale taxpayers may request their tax authority to issue special VAT invoices on their behalf so their customers can use it to claim an input VAT credits. Effective from February 2020, small scale taxpayers (except individuals) can issue special VAT invoices by themselves through the Golden Tax System'. However, if the small scale taxpayers can opt to issue special VAT invoices directly, they cannot request their tax authority to issue special VAT invoices on their behalf.

## 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 RMB 10,000.

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

**A** Special VAT invoices, known as "fapiaos", can only be issued 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 when it is requested by the customer.



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



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. General invoices can only be issued through the Golden Tax System, but cannot be used to claim input VAT credits.



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



Self-billing is generally not permissible in China. One of the exceptions is where the supplier sells raw agricultural goods. The supplier would not issue VAT invoices and the customer may apply to the tax authority for issuing buyer created invoices.



### Can businesses issue invoices electronically?



Special VAT invoices in China are generally still issued in paper form using anti-counterfeit electronic systems (known as 'the Golden Tax System'). However, 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. It is expected electronic invoicing for special VAT invoices will be further expanded during 2021. It is already widely used for general VAT invoices.



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



Not applicable in general situations.



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



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



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



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

**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.

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).

# 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/zero-rating waiver. The tax exemption/zero-rating 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?**

**Q**

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

**A**

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

**A**

Not applicable.

**Q**

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

**Q**

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

**A**

Not applicable.

**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 without reasonable commercial reason, 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.

- 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.

**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 interest regime 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;

# Tax authorities

## Q

### Tax audits

## A

#### 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.

## Q

### Advance rulings and decisions from the tax authority

## A

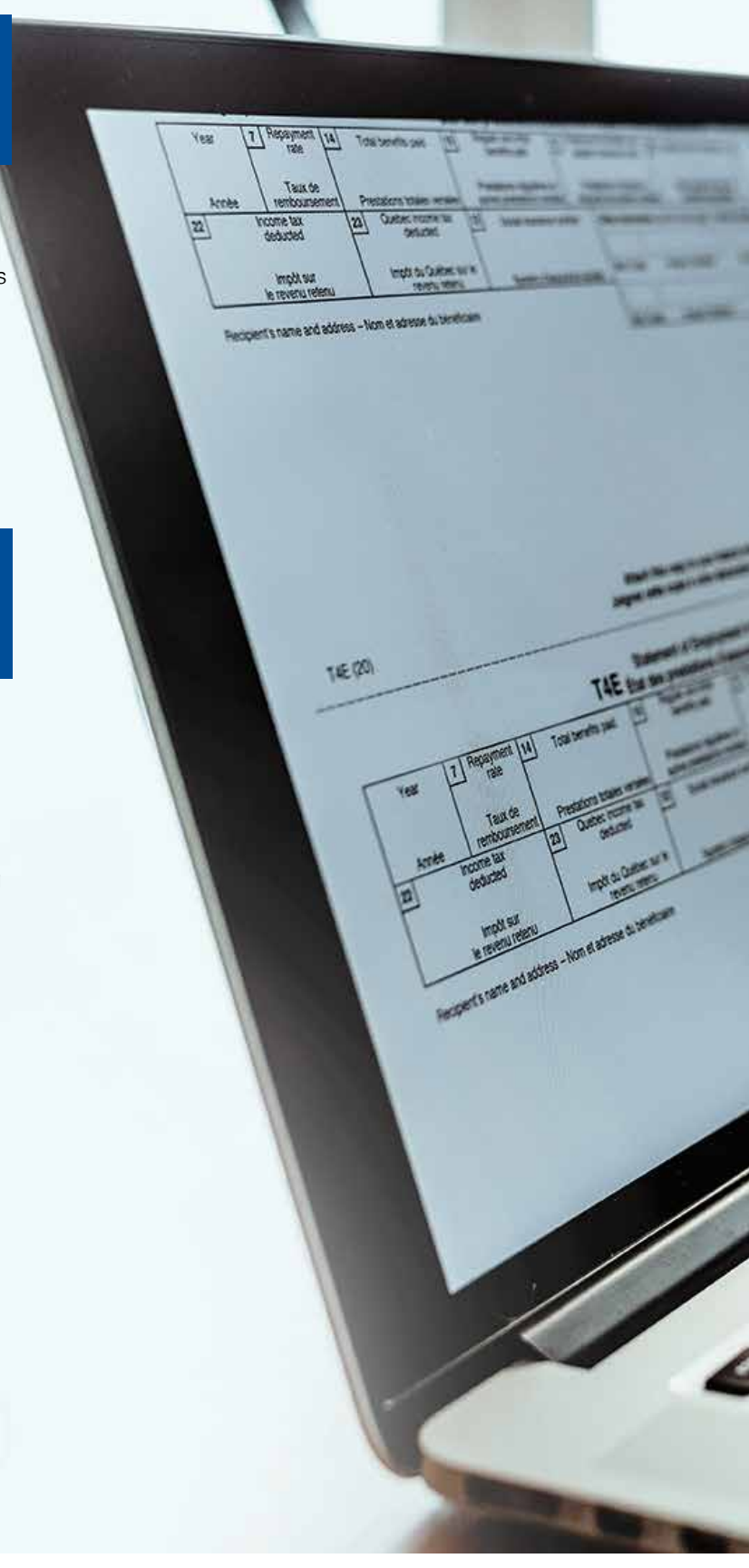
#### Is it possible to apply for formal or informal advance rulings from the (indirect) tax authority?

It is very uncommon. There is currently no formal advance ruling mechanism in China except for transfer pricing related matters. A pilot trial of implementing advance rulings has been adopted in some districts, such as Nansha district in Guangzhou, 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.



Year	7	Repayment rate	14	Total benefits paid	25
Année		Taux de remboursement		Prestations totales versées	
22		Income tax deducted	23	Quotient income tax deducted	24
		Impôt sur le revenu retenu		Impôt du Québec sur le revenu retenu	

Recipient's name and address – Nom et adresse du bénéficiaire

# 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 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;
- 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 submitting an application form to issue a red letter invoice. This can be cumbersome.

**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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