CHINA TAX ALERT

ISSUE 30 I November 2015

VAT zero rating concession for exported service scope expanded

Regulation discussed in this issue:

- Circular Caishui [2015] 118

On 30 October 2015 China's Ministry of Finance ("MoF") and State Administration of Taxation ("SAT") jointly issued Circular Caishui [2015] 118 ("Circular 118") which introduces Value Added Tax ("VAT") zero rating for certain exported services, to replace the existing VAT exemption treatment. VAT zero rating means that a taxpayer not only does not pay VAT on the services it performs, but it is also entitled to full input VAT credits (and if applicable, refunds) for the expenses it incurs which relate to providing those services.

Circular 118 is an important step in the implementation of the State Council's broader strategy of promoting the development and international competitiveness of its exported services sector, recently encapsulated in Circular Guofa [2015] 8 (Circular on accelerating the development of the services industry).

The three categories of services affected by the new VAT zero rating treatment comprise:

(1) offshore outsourcing services (consisting of information technology outsourcing (ITO) services, technical business process outsourcing (BPO) services and technical knowledge process outsourcing (KPO) services);
(2) radio, television and film production and publishing services; and
(3) technology transfers, software services, circuit design and testing services, information system services, business process management services and energy management services (except where the object of the energy management contract is located in mainland China) provided to overseas entities.

This new zero rating concession is to apply from 1 December 2015. It is understood that the SAT will introduce implementation rules to give effect to Circular 118 later this month.

KPMG comment

Circular 118 will be greeted favorably by taxpayers, and marks a further shift in China's VAT system conforming with international norms. According to the OECD's "International VAT/GST Guidelines" (April 2014), exports should "not be subject to tax with a refund of input taxes" (i.e. zero rating should apply). The MoF has recently indicated their objective is for zero rating to apply to all exported services. It is therefore expected that this change merely represents the first stage in that shift, though Circular 118 is silent on the timeline for any further changes.

Until now, the categories of zero rated services in China has been relatively limited for exported services – it has only applied to research and development, design services and certain international transportation services. Circular 118 now expands the scope of zero rated exported services, which means that taxpayers can claim related input VAT credits (and refunds, where applicable) on those services, when previously such input VAT credits were required to be denied or transferred out.

Categories of VAT zero rating and exemption exported services

For convenience, we have summarized the key categories of exported services which are eligible for zero rating and exemption in China, following the introduction of Circular [2015] 118:-

Industry	Type of exported services	VAT treatment
International transportation	• International transportation services provided by Chinese domestic carriers	Zero-rated
	• Other unlicensed international transportation	Exemption
	• Voyage charter services	Exemption
Aerospace transportation services	• Aerospace transportation services provided by Chinese domestic carriers	Zero-rated
	• Other unlicensed aerospace transportation services	Exemption
Radio, film and television services	• Production and publishing of radio, films and television programs for overseas entities	Zero-rated (previously exempt)
	• Broadcast of radio for overseas entities	Exemption
Research and development (R&D) and technical services	• Technology transfer provided to overseas entities	Zero-rated (previously exempt)
	• Research and development services provided overseas entities	Zero-rated
	• Technical advisory services	Exemption
	• Energy management services (except where the object of the energy management contract is located in mainland China) provided to overseas entities	Zero-rated (previously exempt)
	• Engineering as well as exploration services with the related project or mineral resources located outside of China	Exemption
Certification and consulting services	• Certification, verification and consulting services provided to overseas entities (except for services in relation to goods or immovable property located in mainland China)	Exemption
Offshore outsourcing services	• Offshore outsourcing services (known as ITO, BPO and KPO services)	Zero-rated (previously exempt)
Information technology (IT) services	• Software services, circuit design and testing services, information system services, business process management services provided to overseas entities.	Zero-rated (previously exempt)

Telecommunication services	• Telecommunications services (both basic and value-added) (i.e. global roaming) provided by Chinese entities to overseas entities	Exemption
Cultural and creative services	• Trademark and copyright transfer services, intellectual property services provided to overseas entities	Exemption
	• Convention and exhibition services located outside of China	Exemption
	• Advertising services where the related advertisement is released outside of China	Exemption
Logistics and ancillary services	• Logistics and ancillary services provided to overseas entities (except warehousing services and letter & parcel receipt & distribution services)	Exemption
	• Warehousing services provided to overseas entities, where the warehouses located outside of China	Exemption
	• Letter and parcel receipt and distribution services provided to overseas entities where the related goods are exported out of China	Exemption
	• Letter & parcel receipt & distribution services where the related goods are exported out of China and provided by an overseas entity or individual	Not subject to VAT
Postal services	• Postal services where the related goods are exported out of China	Exemption
	• Postal services where the related goods are exported out of China and provided by an overseas entity or individual	Not subject to VAT
Leasing of tangible movable property	• Leasing of tangible movable property where the asset is being used outside of China	Exemption

Key issues in practice

- When the VAT pilot program first commenced in 2012, many companies were faced with the choice of applying for VAT exemption under the offshore outsourcing services exemption (which itself, had been an exemption contained in the old Business Tax system), or to apply for VAT exemption as an exported service, commonly on the basis that the services were of a consulting nature. When faced with that choice, many companies chose the latter concession because it was administratively easier to obtain. Specifically, the practical difficulty with the offshore outsourcing services exemption is that it often required approvals from multiple government agencies, and was narrower in scope. These changes now make it more beneficial to utilise the offshore outsourcing services exemption for many taxpayers, and therefore this choice may need to be revisited. Ideally, there should have been a level playing field in terms of the tax benefits under each of these concessions, and in time it is hoped that zero rating will be expanded further to achieve neutrality.

- The approach to claiming zero rating in China can be complex, and the administrative practices from province to province do differ. Historically, taxpayers have had to go through cumbersome administrative processes in order to claim zero rating concessions and documentation has been closely scrutinized by the tax authorities. It is expected that similar scrutiny will be applied to these new categories of zero rating, though for taxpayers which already benefit from VAT exemption for these services (pre-1 December 2015), it will be interesting to see what (if any) new implementation requirements will be introduced by the SAT for taxpayers seeking to prospectively upgrade their claims.

- History would show that zero rating claims made on a retrospective basis are more heavily scrutinized than those made on a prospective basis only. The practical reason is because retrospective claims obviously impact on tax authorities budgets and revenue collections which have already occurred. Taxpayers are therefore urged to apply for VAT zero rating (for new claims), or change the basis of existing exemption claims to upgrade to zero rating as soon as possible from 1 December 2015, so as to minimise unnecessary scrutiny.

- China's VAT system currently zero rates exports of goods. However, zero rating in the context of exports of goods does not mean the same thing as that term is ordinarily understood internationally. Exporters of goods do not pay output VAT, but there are different categories of refund rates which are applied by the government (ranging from 0% to 17%) for different types of goods. The applicable refund rate is determined by reference to the HS Customs code of the goods. Interestingly, there is no similar limitation on claiming refunds for the services industry. Yet again this highlights the use the Chinese government makes of its indirect tax system as a tool for achieving its economic growth agenda.

- Businesses currently eligible for VAT exemption under the three categories of affected services should consider, within reasonable bounds, whether any purchases can be deferred until 1 December 2015 to maximise related input VAT credit claims.

For further information on the new zero rating of services, please contact your KPMG advisor.

Khoonming Ho
Partner in Charge, Tax
China and Hong Kong SAR
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

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

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

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

Shanghai/Nanjing
Lewis Lu
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Chengdu
Anthony Chau
Tel. +86 (28) 8673 3916
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 China

David Ling
Partner in Charge, Tax
Northern China
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Vaughn Barber
Tel. +86 (10) 8508 7071
vaughn.barber@kpmg.com

Yali Chen
Tel. +86 (10) 8508 7571
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

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

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

Naoko Hirasawa
Tel. +86 (10) 8508 7054
naoko.hirasawa@kpmg.com

Josephine Jiang
Tel. +86 (10) 8508 7511
josephine.jiang@kpmg.com

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

Li Li
Tel. +86 (10) 8508 7537
li.li@kpmg.com

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

Thomas Li
Tel. +86 (10) 8508 7574
thomas.li@kpmg.com

Simon Liu
Tel. +86 (10) 8508 7565
simon.liu@kpmg.com

Paul Ma
Tel. +86 (10) 8508 7076
paul.ma@kpmg.com

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

Vincent Pang
Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

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

State Shi
Tel. +86 (10) 8508 7090
state.shi@kpmg.com

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

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

Jessica Xie
Tel. +86 (10) 8508 7540
jessica.xie@kpmg.com

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

Tiansheng Zhang
Tel. +86 (10) 8508 7526
tiansheng.zhang@kpmg.com

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

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

Central China

Lewis Lu
Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

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

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

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

Marianne Dong
Tel. +86 (21) 2212 3436
marianne.dong@kpmg.com

Alan Garcia
Tel. +86 (21) 2212 3509
alan.garcia@kpmg.com

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

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

Dylan Jeng
Tel. +86 (21) 2212 3080
dylan.jeng@kpmg.com

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

Flame Jin
Tel. +86 (21) 2212 3420
flame.jin@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

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

Henry Ngai
Tel. +86 (21) 2212 3411
henry.ngai@kpmg.com

Yasuhiko Otani
Tel. +86 (21) 2212 3360
yasuhiko.otani@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

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 (21) 2212 3438
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

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

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

Southern China

Lilly Li
Partner in Charge, Tax
Southern China
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Penny Chen
Tel. +1 (408) 367 6086
penny.chen@kpmg.com

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

Sam Fan
Tel. +86 (755) 2547 1071
sam.kh.fan@kpmg.com

Joe Fu
Tel. +86 (755) 2547 1138
joe.fu@kpmg.com

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

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

Angie Ho
Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Ryan Huang
Tel. +86 (20) 3813 8621
ryan.huang@kpmg.com

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

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

Donald Lin
Tel. +86 (20) 3813 8680
donald.lin@kpmg.com

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

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

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

Michelle Sun
Tel. +86 (20) 3813 8615
michelle.sun@kpmg.com

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

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

Hong Kong

Ayesha M. Lau
Partner in Charge, Tax
Hong Kong SAR
Tel. +852 2826 7165
ayesha.lau@kpmg.com

Chris Abbiss
Tel. +852 2826 7226
chris.abbiss@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

Rebecca Chin
Tel. +852 2978 8987
rebecca.chin@kpmg.com

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

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

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

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

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

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

John Kondos
Tel. +852 2685 7457
john.kondos@kpmg.com

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

Jocelyn Lam
Tel. +852 2685 7605
jocelyn.lam@kpmg.com

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

Steve Man
Tel. +852 2978 8976
steve.man@kpmg.com

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

Curtis Ng
Tel. +852 2143 8709
curtis.ng@kpmg.com

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

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

Nicholas Rykers
Tel. +852 2143 8595
nicholas.rykers@kpmg.com

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

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

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

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

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

Christopher Xing
Tel. +852 2978 8965
christopher.xing@kpmg.com

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

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

kpmg.com/cn