

A Remarkable Year of VAT Reform in China

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In brief

In order to achieve substantial reduction of Value-added Tax ("VAT"), the Ministry of Finance, State Taxation Administration and General Administration of Customs jointly issued the <Public Notice on Relevant Policies for Deepening VAT Reform> ("PN 39") on 21 March 2019. Relevant authorities were urged to implement the policies stated in the <Government Working Report> announced by Premier Li Keqiang, and PN 39 points out the direction and path for further implementation of the new policies to deepen the VAT Reform effective from 1 April 2019.

A series of VAT circulars was released subsequently (including <Public Notice of Certain Matters Regarding Deepening the VAT Reform> ("PN 14") and <Public Notice Regarding Adjusting the VAT Filing Matters> ("PN 15"), etc.) to further clarify the implementation details on specific operational issues in relation to the VAT invoice issuance, one-off input VAT credit of purchased property, input VAT super-credit policy and adjustment on VAT filing returns.

In detail

1. Reduction of VAT rates and export VAT refund rates

VAT rate of 16% is reduced to 13% and the VAT rate of 10% is lowered to 9%. The export VAT refund rate of 16% and 10% are reduced to 13% and 9% accordingly. A three-month transitional period has been set for the adoption of the export VAT refund rate.

Interpretation:

The original VAT rate of 16% that applies to general goods, processing, repair and replacement services and rental of moveable assets, has been adjusted to 13%. The original VAT rate of 10% that applies to agricultural products, transportation services, postal services, construction services, lease of real property, sale of real property and the use right of land has been adjusted to 9%.

With the reduction of VAT rate on the taxable transactions, the corresponding export refund rate is reduced simultaneously. Meanwhile, during the transitional period, the original export VAT refund rate could still be adopted to maintain the competitiveness of the corresponding goods and services for export business.

2. Adjustment on VAT deduction rate for agricultural products and VAT refund rate for exportation

With respect to agricultural products purchased by a taxpayer, the VAT deduction rate of 10% is lowered to 9%; with respect to those agricultural products purchased by a taxpayer for the production or processing of goods which is subject to VAT rate of 13%, the input VAT shall be calculated based on the deduction rate of 10%.

Interpretation:

When a general VAT payer purchases agricultural products, the input VAT could be calculated by multiplying the purchase price indicated in the invoice of agricultural products by the VAT deduction rate. With the reduction of VAT rate of agricultural



products to 9%, the deduction rate has been adjusted to 9% as well. At the same time, in order to ensure those processing enterprises for agricultural products to enjoy the preferable deduction rate when the VAT rate of agricultural products was lowered from 13% to 11% in 2017, the deduction rate was determined at 13%; when the VAT rate of agricultural products was lowered from 11% to 10% in 2018, the deduction rate was determined at 12%. Since April 2019, the VAT rate of agricultural products is further lowered from 10% to 9%, and the corresponding deduction rate will be determined at 10%, which reflects the principle to benefit all industries from the tax reform.

3. One-off input VAT credit for purchased real property

The input VAT for real property purchased after April 2019 could be one-off credited. For those property purchased before April 2019, the remaining 40% of total input VAT amount could be credited one-off in the April 2019 filing period.

Interpretation:

After the completion of “B2V” reform on 1 May 2016, the input VAT for purchased real property and construction in process could be credited in two years on a 60% / 40% basis, that is, the first 60% could be credited in the month when relevant VAT invoice is obtained and the remaining 40% could be credited in the 13th month. PN 39 allows an one-off input VAT credit of purchased real property which could improve the cash flow efficiency and reduce financial burden of taxpayers. Meanwhile, for those property purchased before April 2019, the remaining 40% of total input VAT amount could be credited at once in the April 2019 filing period.

4. Input VAT credit for purchasing domestic passenger transportation services

Input VAT incurred for domestic passenger transportation services could be credited.

Interpretation:

In line with the principle of VAT, the input VAT of expenditure related to production and operation of enterprises shall be credited. Previously, the VAT incurred on passenger transportation was not allowed for credit. The reason could be the difficulties for the tax authorities to control and distinguish whether such transportation was for personal consumption or business operation. Nowadays with the development of real-name system and digitization in passenger transport industry, it is the proper timing to include such input VAT for credit.

It is worth noting that in addition to the special VAT invoices, there are other certificates listed that are allowed for input VAT credit, including the general VAT E-invoice, airline E-ticket with passenger information, railway ticket with passenger information, roads, waterways, and other tickets with passenger information.

It implies that those certificates without passenger information cannot be used for input VAT credit. One more point to be noted is that, the input VAT of services purchased for employee welfare and personal consumption is not allowed for credit. In this regards, taxpayers shall separate the transportation invoices / tickets obtained for employee welfare and personal consumption.

5. Additional 10% super-credit

From 1 April 2019 to 31 December 2021, qualified taxpayers of certain service industries could enjoy an additional 10% VAT super-credit to offset against its VAT payable.

Interpretation:

To ensure taxpayers from all industries could benefit from the tax cut, PN 39 introduces the input VAT super-credit policy, and confirm the applicable period, scope, calculation methodology and inapplicable situations. Taxpayers shall pay attention to the following:

1) The eligibility for enjoying super-credit policy

From 1 April 2019 to 31 December 2021, general tax payers engaged in industries of postal services, telecommunication services, modern services and consumer services are allowed to claim an additional 10% super-credit against their VAT payable. Taxpayers need to have more than 50% of their revenues generated from the above four categories in the prior year in order to enjoy the super-credit scheme.

2) The scope of applicable situations

The input VAT corresponding to goods/services for export is not eligible for super-credit. If taxpayers are engaged in both export of goods and services and domestic taxable activities and the input VAT could not be clearly distinguished, the qualified input VAT for super-credit shall be calculated based on the proportion of sales income.

Taxpayers shall establish separate reconciliation book to check and calculate the changes in the accruals, deductions, reduction and balances, etc. of the additional super-credit and revisit the eligibility for super-credit policy on yearly basis.

6. Excess input VAT refund

The incremental excess input VAT could be refunded to qualified taxpayers on a pilot basis since 1 April 2019.

Interpretation:

The implementation of the excess input VAT refund could help reduce financial burden of taxpayers and enhance their cash flow efficiency. For the accumulative input VAT balance, PN 70 which was issued in 2018 provides that qualified enterprises in the 18 listed industries and power grid enterprises are eligible to enjoy accumulative input VAT balance refund. While PN 39 has specified the conditions and calculation methods for the incremental excess input VAT refund. Taxpayers shall pay attention to the following:

1) Criteria for excess input VAT refund policy

The increment of ending balance of input VAT balance is greater than zero for six consecutive months (two consecutive quarters) and the sixth month's incremental ending balance must exceed RMB 0.5 million. The incremental excess input VAT refers to the incremental amount compared with the ending balance as of March 2019.

2) The tax credit rating of taxpayer should be Grade A or Grade B.

3) No illegal matters occurred within the 36 months prior to the application for excess input VAT refund.

4) Neither of the preferential policies of VAT refund upon collection and tax refund (rebate) after collection is enjoyed from 1 April 2019.

5) Calculation of incremental input VAT refund

The incremental excess input VAT balance could be partially refunded, following the calculation method:

Input VAT refund = Incremental ending balance of excess input VAT * Input composition ratio * 60%

The input composition ratio refers to the proportion of the VAT indicated in the credited special VAT invoices from April 2019 to the previous taxation period prior to applying for the input VAT refund, the customs import special VAT payment certificate, the remitted VAT payment receipt and all the credited input VAT for the same period.

6) The taxpayer shall made application to the competent tax authority for refund of the incremental excess input VAT balance within the VAT filing period.

7) After taxpayer obtains refund of input VAT, the input VAT balance for the current period shall be reduced accordingly.

8) If the above criterions for refund are met again after the first application, the second application could be further submitted to the competent tax authority. If the enterprise has met the corresponding requirements for refund application, it can apply for a refund of incremental input VAT credit in every six months.

7. Relevant provisions on VAT invoice, VAT system and VAT filing return

Where a VAT invoice is issued based on the original 16% or 10% VAT rates prior to the reform and is required to issue a "red-letter" VAT invoice due to sales discount, sales rebate or sales return, the "red-letter" VAT invoice shall be issued based on the original VAT rates. Where a VAT invoice is falsely issued and is required to be re-issued with the same amount, taxpayer shall issue the correct invoice with the original VAT rate after the "red-letter" VAT invoice issuance.

For those sales whose VAT liability has already been triggered before this VAT reform and the VAT invoices will be issued afterwards, the original VAT rate shall apply.

The VAT invoice issuance system will display the adjusted VAT rates after VAT reform. If the original VAT rates are required, taxpayers could manually select the original VAT rates to issue VAT invoices.

Taxpayers shall issue VAT invoices in accordance with the updated <Tax Classification and Code for Goods and Services>.

Meanwhile, SAT has updated the VAT tax filing return format in accordance with the updated policy. Taxpayers shall pay attention to the revised terms and conditions, and follow the latest instructions to report the new VAT filing return.

The takeaway

The VAT reform policies will benefit a vast variety of industries. The policies are quite complicated with a short preparation period for tax payers though.

Taxpayers are recommended to pay great attention to this VAT reform. On one hand, taxpayers should make self-assessment to fully enjoy the benefits of relevant policies. On the other hand, taxpayers need to focus on routine management of invoices, certificates for credit and any other supporting documents. Management is suggested to be well prepared for the new opportunities as well as new challenges, including keeping close eye on the policies, upgrade the VAT invoice issuance system and the financial systems, review and revisit of the existing contracts, etc.



Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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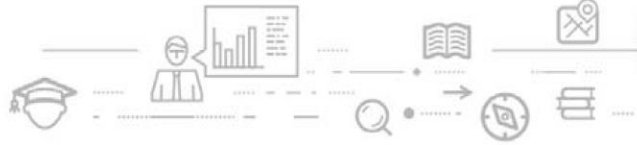
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