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# China VAT Reform Updates: How Can You Prepare?

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# Part 1

## VAT Reform Updates

# VAT Reform Updates – Ministry of Finance and SAT No.32

## Circular Content

### Sales

For taxpayers who have VAT taxable sales activities or goods imports:

- 17% reduces to **16%**
- 11% reduces to **10%**

### Purchase of Agricultural Products

- The deduction rate of 11% originally applicable to the taxpayers who purchase agricultural products is adjusted to **10%**;
- When taxpayers purchase agricultural products for production, sales, or consignment processing, to which the tax rate of 16% is applicable, the input tax amount shall be calculated at the deduction rate of **12%**.

### Export VAT Refund

- Goods/ service exported by trading companies before **31<sup>st</sup> July 2018**:
  - ❖ if VAT has been levied at 17% at the time of purchase, the export rebate rate is 17%;
  - ❖ if the VAT has been levied at 16% at the time of purchase, 16% export tax rebate rate shall be applicable.
- Goods/ service exported by manufacturing companies before **31<sup>st</sup> July 2018**:
  - ❖ the export rebate is 17%.



# VAT Reform Updates – Ministry of Finance and SAT No.32

## History of VAT Reform in China

### VAT & BT

- VAT on manufacturing & sale of goods
- BT on service

### VAT Pilot nationwide

- VAT on manufacturing & sale of goods; transportation service & modern service
- BT on other service

### VAT Pilot nationwide

- VAT on manufacturing & sale of goods; transportation service & modern service, railway & postal & telecom service
- BT on other service

### VAT 1<sup>st</sup> reduction

- 17%
- 11%
- 6%
- 0%



### VAT Pilot in SH etc.

- VAT on manufacturing & sale of goods; transportation service & modern service
- BT on other service

### VAT Pilot nationwide

- VAT on manufacturing & sale of goods; transportation service & modern service, railway & postal service
- BT on other service

### VAT eliminated BT

- 17%
- 13%
- 11%
- 6%
- 0%

### VAT 2<sup>nd</sup> reduction

- 16%
- 10%
- 6%
- 0%

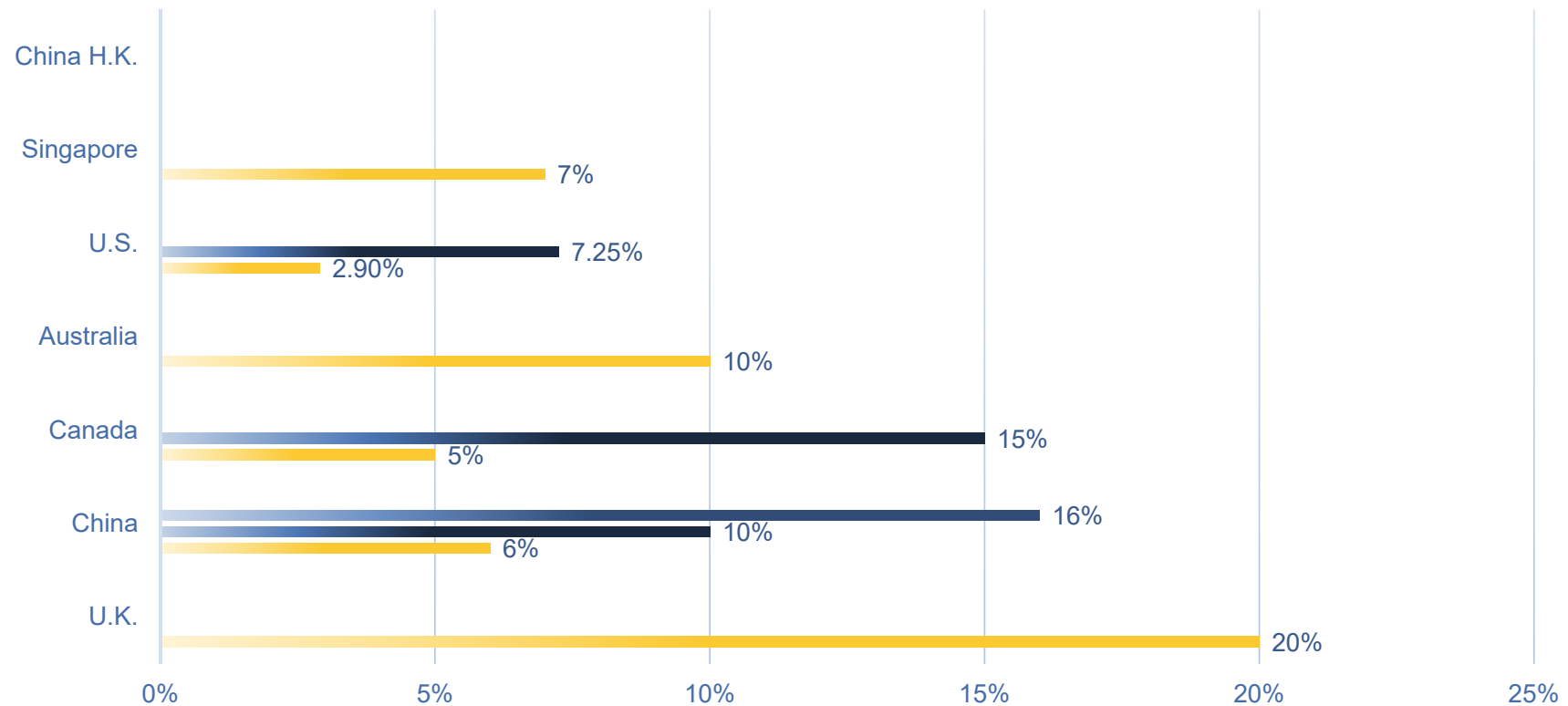
# VAT Reform Updates – Ministry of Finance and SAT No.32

## VAT Rates Update to May 2018

16%	<ul style="list-style-type: none"> <li>• Sales/import of goods</li> <li>• Processing, repairs and replacement service</li> </ul>	<ul style="list-style-type: none"> <li>• Tangible property financial leasing</li> <li>• Tangible property operation leasing</li> </ul>	
10%	<ul style="list-style-type: none"> <li>• Sales/import of specific products</li> <li>• Sales of real estate</li> <li>• Land use right transfer</li> </ul>	<ul style="list-style-type: none"> <li>• Transportation service</li> <li>• Postal service</li> <li>• Basic telecoms service</li> </ul>	<ul style="list-style-type: none"> <li>• Construction service</li> </ul>
6%	<ul style="list-style-type: none"> <li>• Sales of intangible assets</li> <li>• Financial service</li> <li>• Modern service</li> </ul>	<ul style="list-style-type: none"> <li>• Life service</li> </ul>	
0%	<ul style="list-style-type: none"> <li>• Export of goods (except specific products)</li> <li>• International transportation service</li> </ul>	<ul style="list-style-type: none"> <li>• Qualified service provided to overseas entities and consumed out of China</li> <li>• Space transportation service</li> </ul>	

# VAT Reform Updates – Ministry of Finance and SAT No.32

## VAT RATES GLOBAL COMPARISON



## VAT Reform Updates – Ministry of Finance and SAT No.32 Could everyone benefit from the VAT reduction?

$$\text{Price}_{\text{VAT inclusive}} = \left[ \text{Cost} + \text{Profit Markup} \right] \times \left[ 1 + \text{VAT}\% \right]$$

$$117 = (80 + 20) \times (1 + 17\%)$$

$$116 = (80 + 20) \times (1 + 16\%)$$

$$117 = (80 + 20.86) \times (1 + 16\%)$$

Price Up!



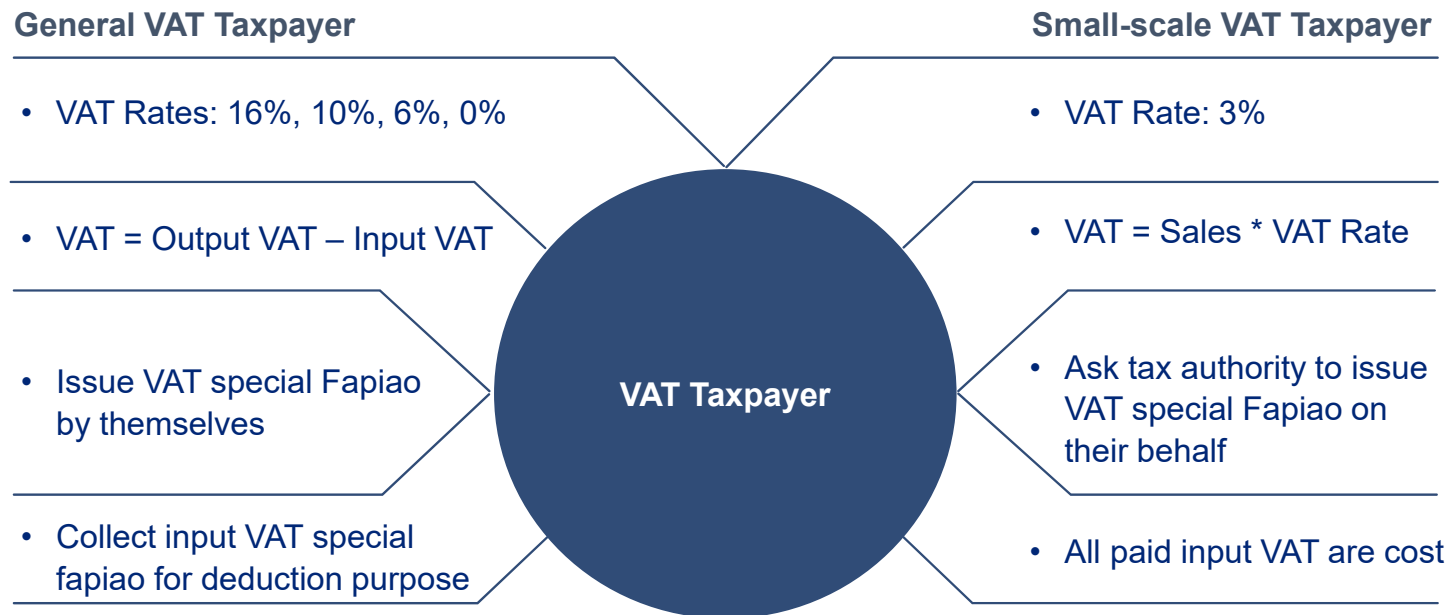
## VAT Reform Updates – Ministry of Finance and SAT No.32

### Could everyone benefit from the VAT reduction?

	Manufacturer					Distributor					Consumer		
	Cost VAT exclusive	Income VAT exclusive	VAT	VAT inclusive price	Gross Profit	Cost VAT exclusive	Income VAT exclusive	VAT	VAT inclusive price	Gross Profit	Cost VAT exclusive	VAT	VAT inclusive price
	a	b	c=b*17%	d=b+c	e=b-a	f=b	g	h=g*17%	i	j=g-f	k=g	l=h	m=k+l
Scenario 0: VAT 17%	60.00	80.00	13.60	93.60	20.00	80.00	100.00	17.00	117.00	20.00	100.00	17.00	117.00
	a	b	c=b*16%	d=b+c	e=b-a	f=b	g	h=g*16%	i	j=g-f	k=g	l=h	m=k+l
Scenario 1: Ideal	60.00	80.00	12.80	92.80	20.00	80.00	100.00	16.00	116.00	20.00	100.00	16.00	116.00
Scenario 2: Manufacturer and Consumer are more powerful in price negotiation	60.00	80.69	12.91	93.60	20.69	80.69	100.00	16.00	116.00	19.31	100.00	16.00	116.00
Scenario 3: Manufacturer and Distributor are more powerful in price negotiation	60.00	80.69	12.91	93.60	20.69	80.69	100.86	16.14	117.00	20.17	100.86	16.14	117.00
Scenario 4: Distributor is more powerful in price negotiation	60.00	80.00	12.80	92.80	20.00	80.00	100.86	16.14	117.00	20.86	100.86	16.14	117.00

# VAT Reform Updates – Ministry of Finance and SAT No.33

## VAT general taxpayer vs. small-scale taxpayer before No. 33



### Compulsory Registration Thresholds:

0.5M to manufacturing taxpayer; 0.8M to trading taxpayer; 5M to service taxpayer.

# VAT Reform Updates – Ministry of Finance and SAT No.33

## Content of the circular

### Small-scale Taxpayer Standard

The criteria for small-scale VAT payers is annual sales of 5 million yuan or less subject to VAT

### General Taxpayer turns to Small-scale Taxpayer

The entities and individuals that have been registered as general VAT payers in accordance with the provisions of Article 28 of the Implementation Rules for the Provisional Regulations of the People's Republic of China on Value-added Tax may be registered anew as small-scale taxpayers before December 31<sup>st</sup> 2018, and the amount of input tax thereof that has not been deducted yet may be transferred out.

## VAT Reform Updates – Ministry of Finance and SAT No.33

### Critical profit mark-up ration on cost

Income VAT exclusive	5	Million		
Profit Mark-up on Cost		20%	23.08%	30%
	VAT Rate	VAT Burden	VAT Burden	VAT Burden
Small-scale taxpayer	3%	0.15	0.15	0.15
General taxpayer	16%	0.13	0.15	0.18
Profit Mark-up on Cost		30%	42.86%	50%
	VAT Rate	VAT Burden	VAT Burden	VAT Burden
Small-scale taxpayer	3%	0.15	0.15	0.15
General taxpayer	10%	0.12	0.15	0.17
Profit Mark-up on Cost		50%	100.00%	150%
	VAT Rate	VAT Burden	VAT Burden	VAT Burden
Small-scale taxpayer	3%	0.15	0.15	0.15
General taxpayer	6%	0.10	0.15	0.18

## VAT Reform Updates – Ministry of Finance and SAT No.33 Standard VAT small-scale taxpayer criteria

### China's New Small-scale Taxpayer Criteria

Industry	Old law	New law
<ul style="list-style-type: none"> <li>• Manufacturing of goods or provision of taxable labor services</li> <li>• Primarily engaging in manufacturing of goods or provision of taxable labor services and concurrently engaging in wholesale or retail of goods</li> </ul>	≤ RMB 500,000	Unified to be ≤ RMB 5 million
Wholesale or retail of goods	≤ RMB 800,000	
Provision of services originally subject to business tax	≤ RMB 5 million	

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# VAT Reform Updates – Ministry of Finance and SAT No.33

## VAT general taxpayer vs. small-scale taxpayer after No.33

### VAT General Taxpayer

#### Advantage:

- Tax-saving when profit mark-up lower than critical ratio;
- Able to apply for VAT refund for export business;
- Enjoy input VAT deduction;
- Could issue VAT special fapiao by themselves.

#### Disadvantage:

- File tax on monthly basis;
- Has to collect VAT special fapiaos and verify them within 360 days to ensure the input VAT deduction;
- Increase tax burden when profit mark-up higher than critical ratio or, unable to collect VAT special fapiao for input VAT deduction.

### VAT Small-scale Taxpayer

#### Advantage:

- Tax-saving when profit mark-up higher than critical ratio;
- File tax on quarterly basis;
- Doesn't need to collect and verify VAT special fapiao for deduction, tax calculation method is straightforward;
- Has VAT exemption benefit for small transaction taxpayer, SAT 2014 No. 57

#### Disadvantage:

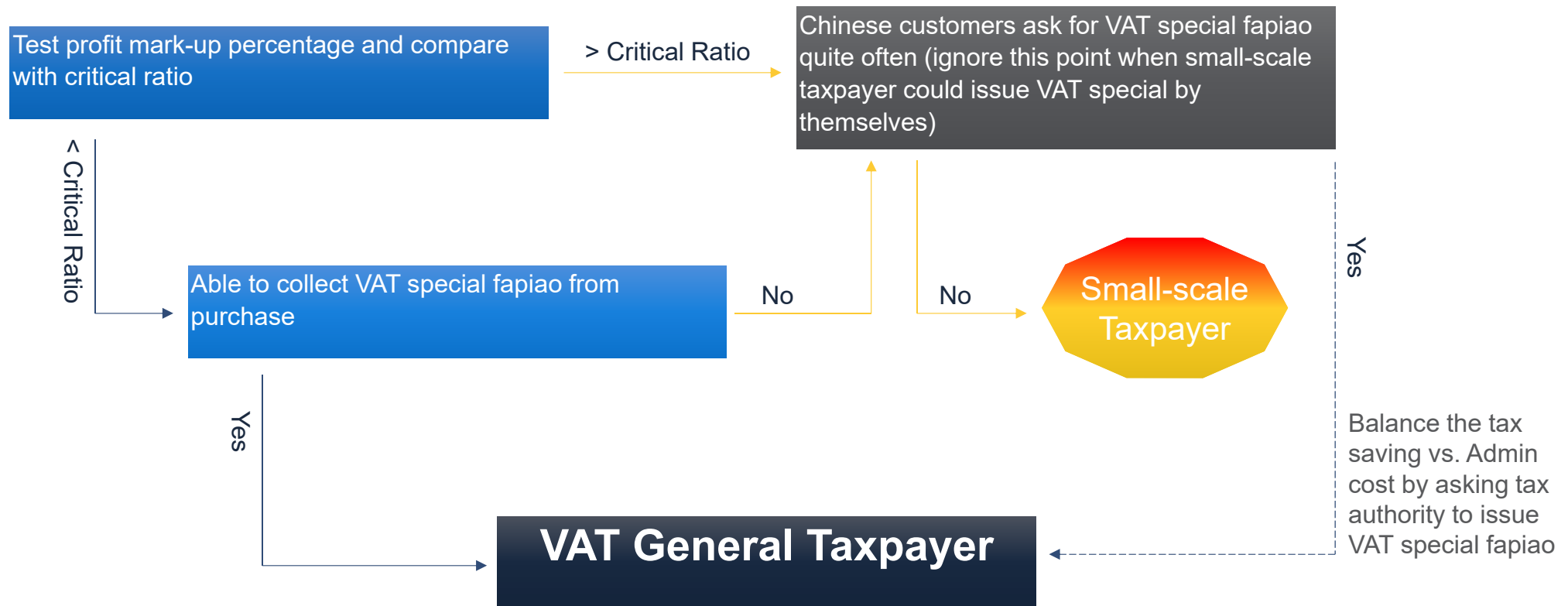
- Unable to apply for export VAT refund but could apply for VAT exemption when qualified;
- Some taxpayer still has to ask tax authority to issue VAT special fapiao on their behalf;
- Not tax efficient when profit mark-up lower than critical ratio;



# VAT Reform Updates – Ministry of Finance and SAT No.33

## VAT general taxpayer vs. small-scale taxpayer after No.33

Decision making for China VAT taxpayer status selection:



# VAT Reform Updates – SAT Announcement No.18

## Registration conditions and procedures



Was compulsively registered as general taxpayer or;  
Sales more than RMB 5M in the past 12 months/4 quarters

Not beneficial to company

### Self Assessment & Preparation

1. Qualification status review
2. Beneficial Testing
3. Tax registration information review & update
4. Notify vendors to issue VAT special fapiao

### Application & Transition

5. Transform application submission at Tax authority **before 31/12/2018**
6. Collect VAT special Fapiao and verify for input VAT deduction
7. Review in process contracts & ensure correct VAT recognition
8. File VAT return as general taxpayer before 15<sup>th</sup> in following month

### Management after transition

9. Turn to small-scale taxpayer from 1<sup>st</sup> of next month
- Turned small-scale taxpayer can issue VAT special fapiao by themselves
- VAT liability has to be recognized according to correct periods it occurred
- Subject to general taxpayer compulsory registration threshold



**Part 2**  
**Contract & Fapiao Management**  
**in Transition Periods**

## VAT Taxable Income Recognition Policy

	Time to recognize VAT income	Apply 17% or 11% VAT	Apply 16% or 10% VAT	Supporting documents
1. VAT fapiao issued in advance	Fapiao issuance day	Fapiao issued before 30 <sup>th</sup> April 2018	Fapiao issued after 1 <sup>st</sup> May 2018	VAT fapiao
2. Goods importation	Importation day declared at China Customs	Goods imported before 30 <sup>th</sup> April 2018	Goods imported after 1 <sup>st</sup> May 2018	1) China Customs declaration form 2) Importation contract 3) Commercial invoice
3. Goods sold upon the receipt of payment	The day the payment is received or; The day the valid documents for requesting payment have been obtained	Payment (requesting document) received before 30 <sup>th</sup> April 2018	Payment (requesting document) received after 1 <sup>st</sup> May 2018	1) Sales contract 2) Bank receipt 3) Relevant documents for requesting payment
4. A. Goods sales and customer charged for advance payment	The day when the goods are transferred	Goods transferred before 30 <sup>th</sup> April 2018	Goods transferred after 1 <sup>st</sup> May 2018	1) Sales contract 2) Way bill of goods transfer
4. B. Goods sales charging advance payment, production periods > 12 months	The day the payment is received or; payment day stated in the contract	Advance payment received before 30 <sup>th</sup> April 2018 or, payment day stated in the contract is before 30 <sup>th</sup> April 2018	Advance payment received after 1 <sup>st</sup> May 2018 or, payment day stated in the contract is after 1 <sup>st</sup> May 2018	1) Sales contract 2) Bank receipt

## VAT Taxable Income Recognition Policy (continued)

	Time to recognize VAT income	Apply 17% or 11% VAT	Apply 16% or 10% VAT	Supporting documents
5. Goods sales on credit or installment	Payment day stated in the contract or; The day when the goods are transferred (without contract)	Payment day stated in the contract is before 30 <sup>th</sup> April 2018 or; Goods transferred before 30 <sup>th</sup> April 2018 when there isn't a signed contract	Payment day stated in the contract is after 1 <sup>st</sup> May 2018 or; Goods transferred after 1 <sup>st</sup> May 2018 when there isn't a signed contract	1) Sales contract 2) Bank receipt 3) Way bill of goods transfer
6. Goods sales by entrusting a bank to collect payment	The day when the goods are transferred and the bank entrust collection formality has been completed	Goods transferred and entrust collection formality completed before 30 <sup>th</sup> April 2018	Goods transferred and entrust collection formality completed after 1 <sup>st</sup> May 2018	1) Sales contract 2) Relevant bank documents 3) Way bill of goods transfer
7. A. Goods consignment sales	The day when the sales payment or the sales list is received (whichever is earlier)	Sales payment or sales list received before 30 <sup>th</sup> April 2018	Sales payment or sales list received after 1 <sup>st</sup> May 2018	1) Sales contract 2) Bank receipt 3) Sales list
7. B. Goods consignment sales, without sales payment or sales list, nor have the goods returned	On the 180 <sup>th</sup> day after the goods have been sent out	Goods transferred before 2 <sup>nd</sup> November 2017	Goods transferred after 3 <sup>rd</sup> November 2017	1) Sales contract 2) Way bill of goods transfer

## VAT Taxable Income Recognition Policy (continued)

	Time to recognize VAT income	Apply 17% or 11% VAT	Apply 16% or 10% VAT	Supporting documents
8. A. Service sales with contract	Payment day or the day stated in the contract or; The day the valid documents for requesting payment have been obtained	Payment day or the day stated in the contract is before 30 <sup>th</sup> April 2018 or; Payment requesting documents received before 30 <sup>th</sup> April 2018	Payment day or the day stated in the contract is after 1 <sup>st</sup> May 2018 or; Payment requesting documents received after 1 <sup>st</sup> May 2018	1) Sales contract 2) Bank receipt 3) Relevant documents for requesting payment
8. B. Service sales without contract	The day when the service provision has been completed	The service provision is completed before 30 <sup>th</sup> April 2018	The service provision is completed after 1 <sup>st</sup> May 2018	1) Sales contract 2) Relevant documents could prove the completion of the service provision
9. Leasing service charging advance payment	The day payment has been received	Payment received before 30 <sup>th</sup> April 2018	Payment received after 1 <sup>st</sup> May 2018	1) Sales contract 2) Bank receipt
10. Deems goods/service sales	The day when the goods are transferred or; The day when the service provision has been completed	Goods transferred or the service provision completed before 30 <sup>th</sup> April 2018	Goods transferred or the service provision completed after 1 <sup>st</sup> May 2018	1) Way bill of goods transfer 2) Relevant documents could prove the completion of the service provision



# VAT Reform – Contract management

*“The total price in this contract is the VAT inclusive price XXX, hereinto the goods/service price is XXX, and the VAT amount is XXX.”*

*“When occurred Chinese Tax law or regulation updates which will result in the tax liability changes of the transaction described in this contract, party XXX will have rights to require additional compensation for underpaid tax amount which is calculated according to the applicable laws and regulations (or require to return the overpaid tax amount which is calculated according to the applicable laws and regulations).”*

## **A. Purchase contract review**

1. Review the in-process purchase contract;
2. Negotiate with vendors to lower the VAT inclusive price;
3. Conclude supplemental agreements.

## **B. Sales contract review**

1. Review the in-process sales contract;
2. Testing the profit influence;
3. Decide and negotiate with customers about VAT inclusive price adjustment;
4. Conclude supplemental agreements.

# VAT Reform – Fapiao Management

- Fapiao system has to be updated timely according to the new VAT rates
- Comply with P.R.C Implementation Regulation for the administrative measures on Fapiao (2014 edition)
- Fapiao shall be issued when recognizing VAT taxable income (clause No. 26)
- Fapiao content shall be consistent with transaction nature and contract terms
- VAT rates 17% and 11% are still valid in fapiao system, fapiao for VAT liability created before 30<sup>th</sup> April 2018 shall be issued in 17% or 11% VAT rates
- Negative fapiao for transaction recognized before 30<sup>th</sup> April 2018 shall be issued in 17% or 11% VAT rates

Producing  
VAT Fapiao

# VAT Reform – Fapiao Management

## Case A

- The contract was signed before May
- According to the VAT recognition rules the transaction should be taxed at 16% or 10%
- However the customer wants the fapiao to be issued at a VAT rate of 17% or 11%

Is this feasible as according to previous VAT rates the company pays even more tax than it should do?

## Case B

- The contract was signed before May
- VAT recognition was filed and paid before May at 17% and 11% rates
- The customer didn't ask for fapiao so the company didn't issue fapiao for the transaction
- After May the customer requires VAT fapiao for the transaction

Can the company issue in 16% or 10% VAT rates?



# Part 3

## Questions & Answers

# Any Questions?

1. So this new regulation has no impact at all on service related VAT (3%/6%), isn't it? [DSA]: No, circular No. 32 will not make influence on VAT 6% bracket, nor impact on small-scale taxpayers.
2. Can you please clarify the "disadvantage" of a small scale tax payer of "unable to apply for export VAT refund BUT could apply for VAT exemption when qualified"? Can you confirm what this VAT exemption refers to and what qualifications would be needed? [DSA]: VAT small-scale taxpayer subjects to simple taxation management method at 3% VAT rate without input VAT deduction. In export transactions, when the exported goods is qualified (please refer to the commodity's HS code, when its export rebate rate is >0%, or export VAT applicable rate is 0%) and export service is qualified (please refer to the attachment 4 in MOF&SAT 2016 Circular No. 36 and SAT 2016 Circular No.29), small-scale taxpayer's sales could be exempted from 3% VAT, but it cannot enjoy VAT refund. Only VAT general-taxpayer could apply for VAT refund.
3. Could you please explain again slide 24? I don't understand what company must avoid to do. [DSA]: Case A, when the transaction should be taxed according to 16% or 10% VAT rates, company should not issue fapiao in 17% or 11% VAT rates for it; Case B, when the transaction should be recognized before May and be taxed at 17% or 11% VAT rates, the fapiao shall be issued in the same periods when revenue recognized, and it should not be issued in 16% or 10%.

# Any Questions?

4. How about if the revenue occurred before May 1st and the rebate occurred after May 1<sup>st</sup>. how could we handle the VAT rate on Fapiao? [DSA]: When revenue was recognized before 1<sup>st</sup> May while the sales is returned (or discounted) after May, the company could apply for negative fapiao issuance, the applicable VAT rate shall be 17% or 11%.
5. Could you please quickly go back to slides 10-12? I'd like to understand the logic who will benefit better. [DSA]: The key factor is the VAT inclusive price adjustment. When venders don't lower down their VAT inclusive price according to the reduced VAT rates, they actually are pricing up and will grab more benefit from the VAT reform.
6. What is the critical rate for profit mark up? [DSA]: To bracket 16% the critical profit mark-up on cost is 23.08%; To bracket 10% the critical profit mark-up on cost is 42.86%; To bracket 6% the critical profit mark-up on cost is 100%. Hereinto the profit mark-up on cost ratio =  $\frac{\text{Added value}}{\text{cost}} * 100\%$



# Any Questions?

7. With the reduced VAT rates on goods from 17% to 16% and 11% to 10%, have the export vat refund rates been reduced likewise? [DSA]: Yes, the export VAT refund rates will be lowered to 16% and 10% as well. Well, there is a transition period provided to both trading exporter and manufacturing exporter: To trading exporter, export transaction occurred before 31<sup>st</sup> July 2018, when the exported goods was purchased in 17% or 11%, it could apply for VAT rebate at 17% or 11%; To manufacturing exporter, export transaction occurred before 31<sup>st</sup> July 2018 could still apply for VAT rebate at 17% or 11%. The lower VAT refund rates will fully come into effect starting from 1<sup>st</sup> August 2018.
  
8. It was stated that it was now possible for a Small-scale VAT Taxpayer to issue special VAT invoices on their own. Do you not need a special printer and verification key from Golden Tax to do so? [DSA]: Please refer to SAT 2017 announcement No. 4, small-scale taxpayer fulfills the criteria could apply for issue VAT special fapiao by itself or, small-scale taxpayer, who adopts MOF&SAT Circular No. 33 and already applied VAT special fapiao quota and device while it was VAT general taxpayer, could still issue VAT special fapiao by itself. Of course, it will need to have a special printer as well as fapiao device.

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