

China Value Added Tax (“VAT”) Update

Presented by

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Agenda

- 1 Background of VAT
- 2 Introduction of B2V Reform
- 3 Effects of B2V reform
- 4 Key Features of B2V Reform
- 5 Case Illustration
- 6 Q&A



1. Background of VAT

History of China VAT System

1979

- First introduced VAT for PRC tax system reform

1984

- Promulgated VAT Regulations (Draft) and imposed VAT on 12 specific items (e.g. machine, car, steel) nationwide

1980

- Trial implementation of VAT pilot regions (e.g. Guangxi Liuzhou and Shanghai) on 3 specific items (e.g. bicycles, sewing machines) in certain provinces

1994

- Implemented Provisional Regulations of VAT (extended to all kind of goods)
- Implemented Provisional Regulations of Business Tax (“BT”)

2009

- Switched from “Production basis” to “Consumption basis”: VAT on fixed assets creditable

Since 2012

- Pilot program of indirect tax reform ➔ Transformation of BT to VAT (“B2V reform”)

1 May 2016

- Released Tax Notice Caishui (2016) No. 36 and Expanded VAT to cover all industries

VAT – Scope of Charge

Levied on enterprises and individuals engaged in:

Sale of goods in China

- ★ goods are tangible movable goods including electricity, steam and gas
- ★ intangible and immovable goods are non-taxable

Provision of processing, repair or replacement services

Importation of goods into China



BT – Scope of Charge

Levied on enterprises and individuals engaged in:

Provision of taxable labour services, including transportation, construction, finance and insurance, post and telecommunications, cultural activities and sports, entertainment, etc.

Transfer of intangible assets

Sale of immovable properties

Within China





2. Introduction of B2V Reform

Purpose of B2V Reform

Resolve non-credibility of BT

Reduce overall tax burdens for taxpayers

Improve efficiency of China's turnover tax system

Transformation of BT to VAT eventually → No BT



Progress of B2V Reform

1 Jan
2012

- In Shanghai
- Transportation
- Modern services

1 Aug
2012

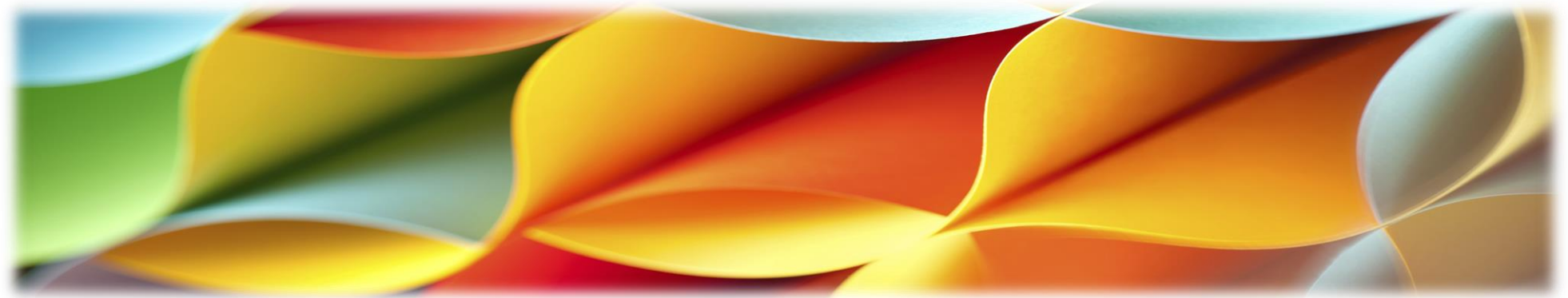
- Expand to 10 other provinces and municipalities: Beijing, Tianjin, Jiangsu, Zhejiang, Anhui, Fujian, Hubei, Guangdong, Xiamen and Shenzhen

1 Aug
2013 – 30
April
2016

- 1 Aug 2013: Expand to nationwide on transportation and modern services
- 1 Jan 2014: Expansion of the reform to railway transportation and postal services
- 1 Jun 2014: Telecommunication services subject to VAT

1 May
2016

- Expand to cover real estate, financial, construction and consumer services
- VAT chain has covered all industries and BT has become history



3. Effects of B2V Reform

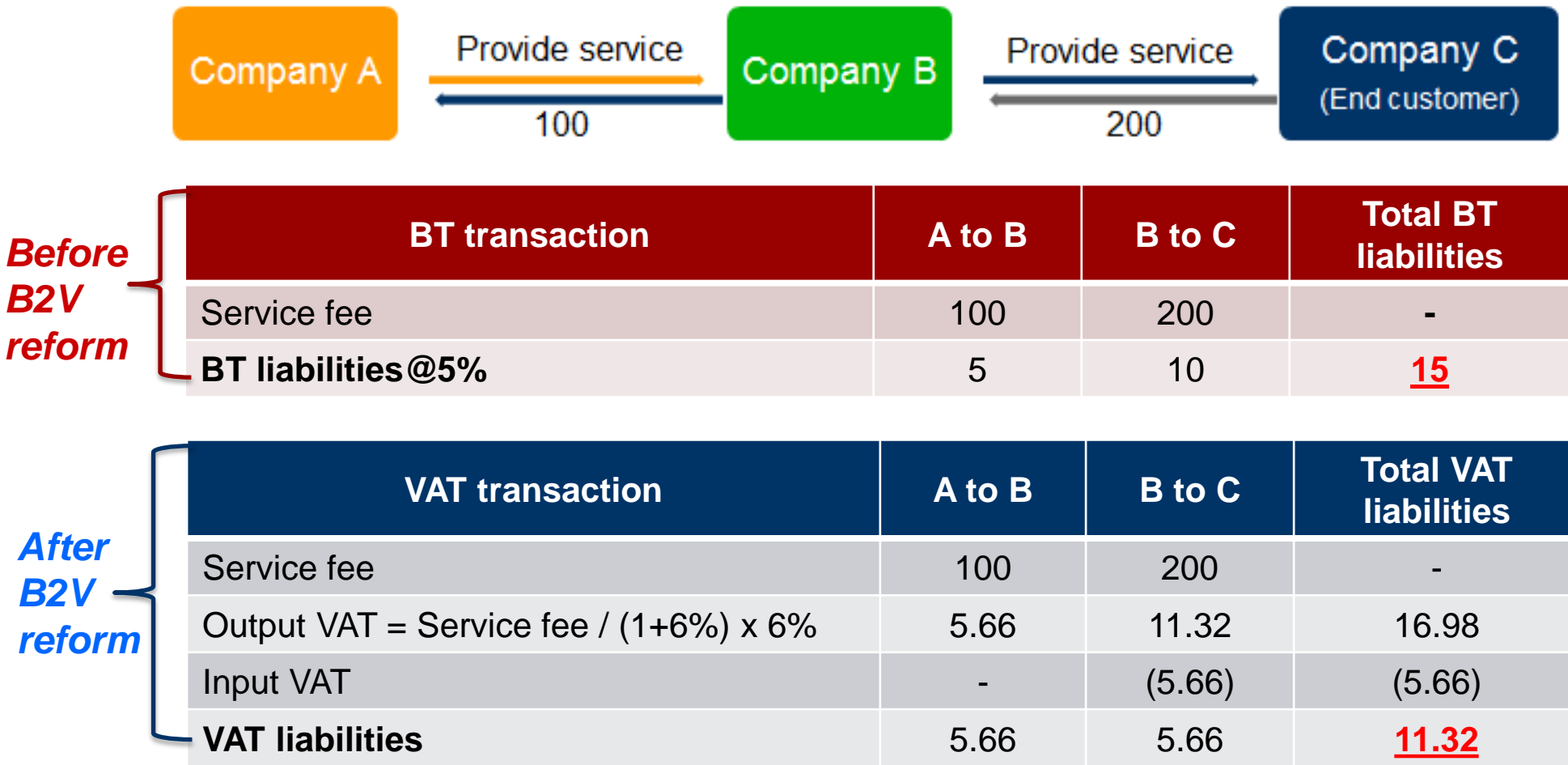
Effects of B2V Reform

As announced by the China government, the reform reduced tax revenue of RMB423.4 billion during Jan to Nov 2016

From May to November 2016

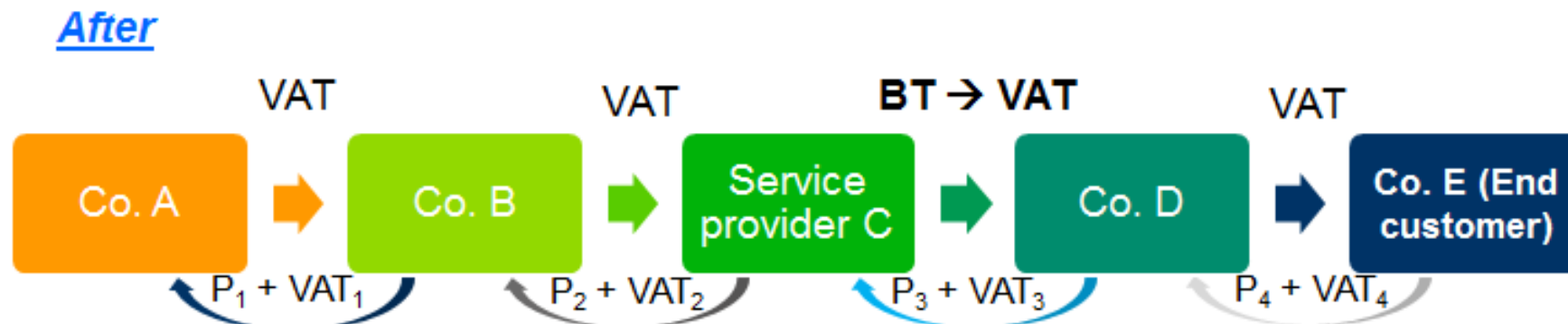
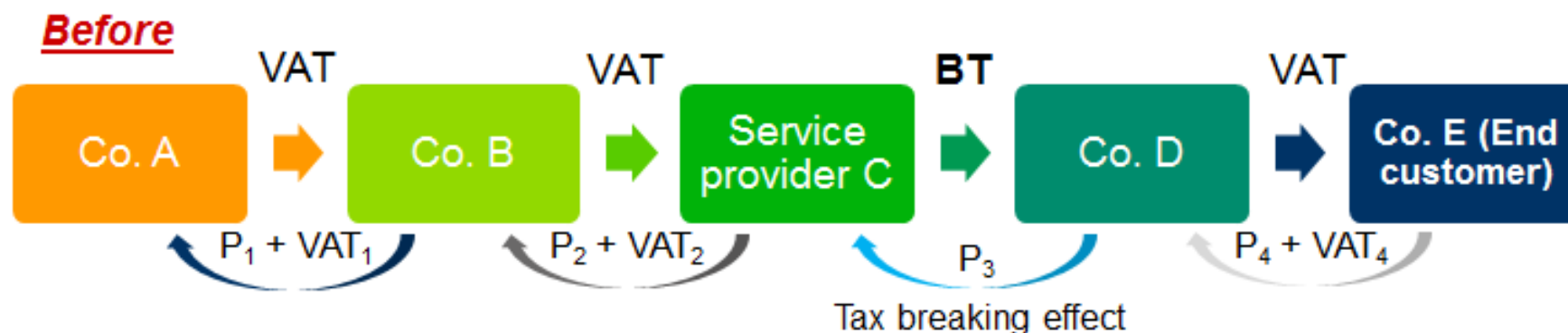
- ➡ Construction sector: ↓ Tax revenue of RMB6.5 billion (3.75%)
- ➡ Real estate sector: ↓ Tax revenue of RMB11.1 billion (7.9%)
- ➡ Financial sector: ↓ Tax revenue of RMB36.7 billion (14.72%)
- ➡ Consumer service sector: ↓ Tax revenue of RMB56.2 billion (29.85%)

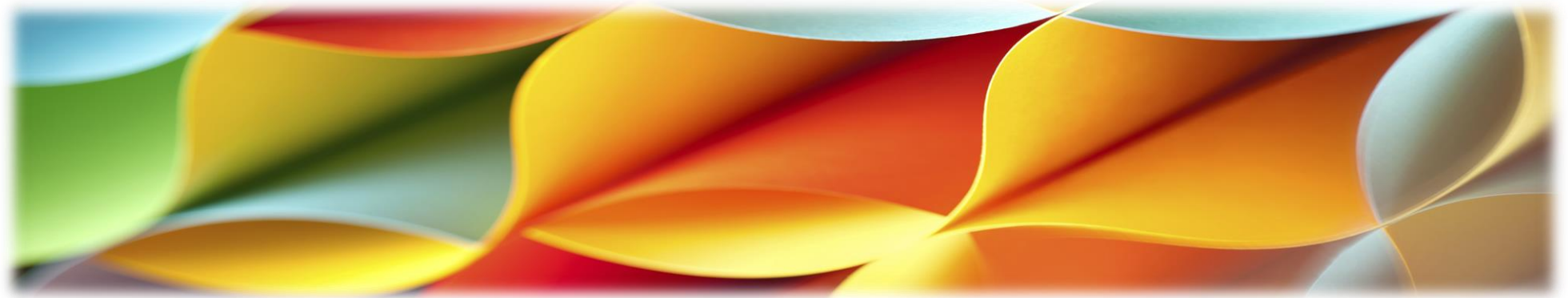
Effects of B2V Reform



Note: We assume B and C will not accept a higher price than before.

Effects of B2V Reform





4. Key Features of B2V Reform

Scope of Charge

Provision of services: transportation, postal, telecommunication, construction, financial services, modern services, consumer services

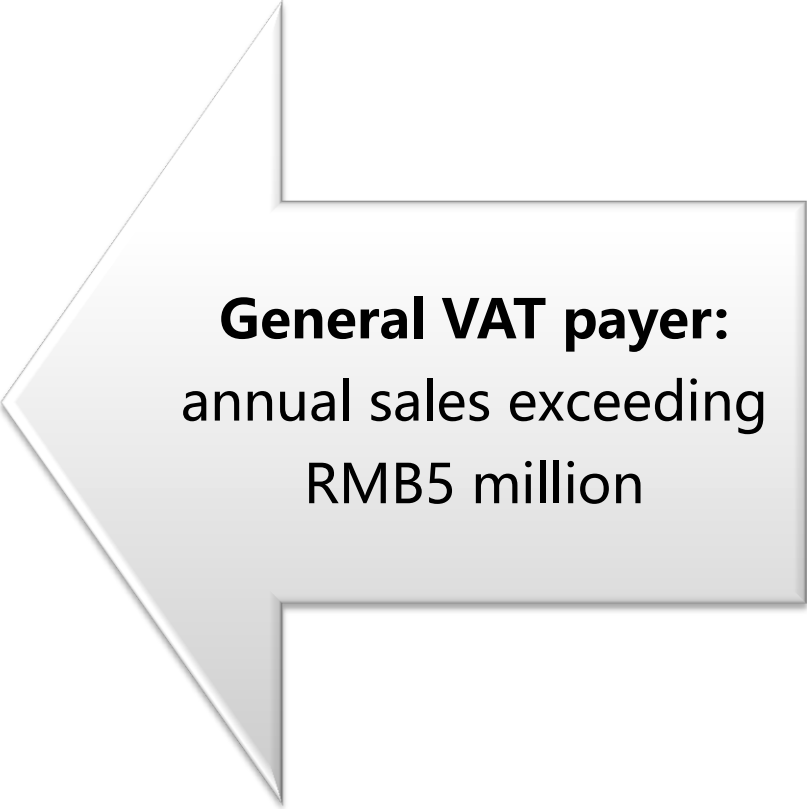
Sale of intangible assets

Sale of immovable properties

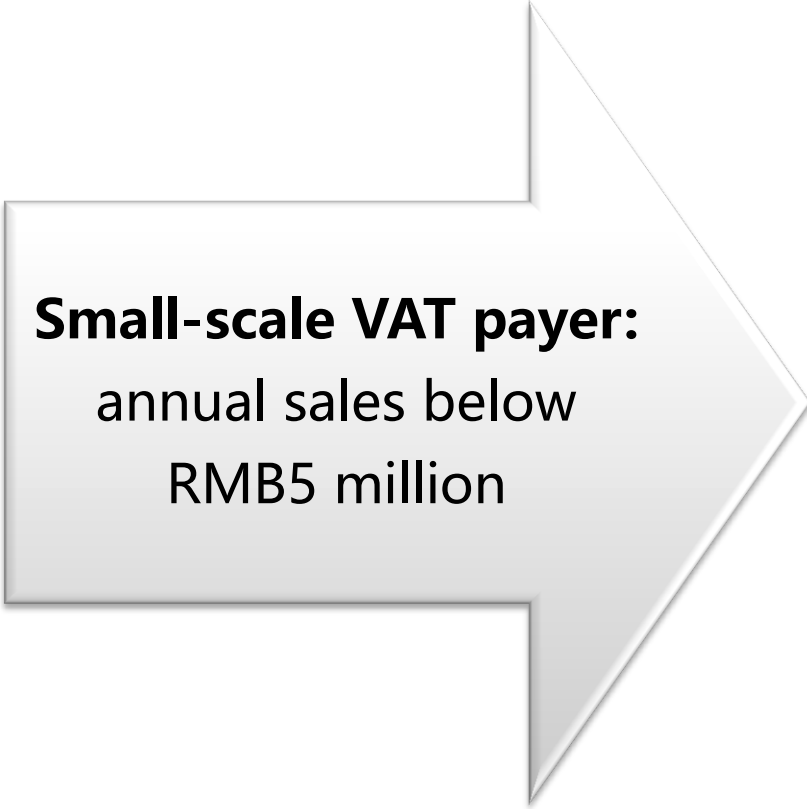
**Within
China**

Types of Taxpayers

2 categories of taxpayers



General VAT payer:
annual sales exceeding
RMB5 million



Small-scale VAT payer:
annual sales below
RMB5 million

VAT Rate

❖ General VAT payer

Taxable services	Category		VAT rate	BT rate
Sale of services	Transportation, postal services, basic telecommunication services, construction		11%	3%
	Value-added telecommunication services		6%	3%
	Financial services, modern services (except for leasing services)		6%	3% / 5%
	Leasing	Leasing of immovable properties	11%	5%
		Leasing of tangible and movable assets	17%	5%
	Consumer services		6%	3% / 5%, 5% - 20% for entertainment
Sale of intangible assets			6%	5%
Sale of immovable assets			11%	5%

❖ Small-scale VAT payer: 3%

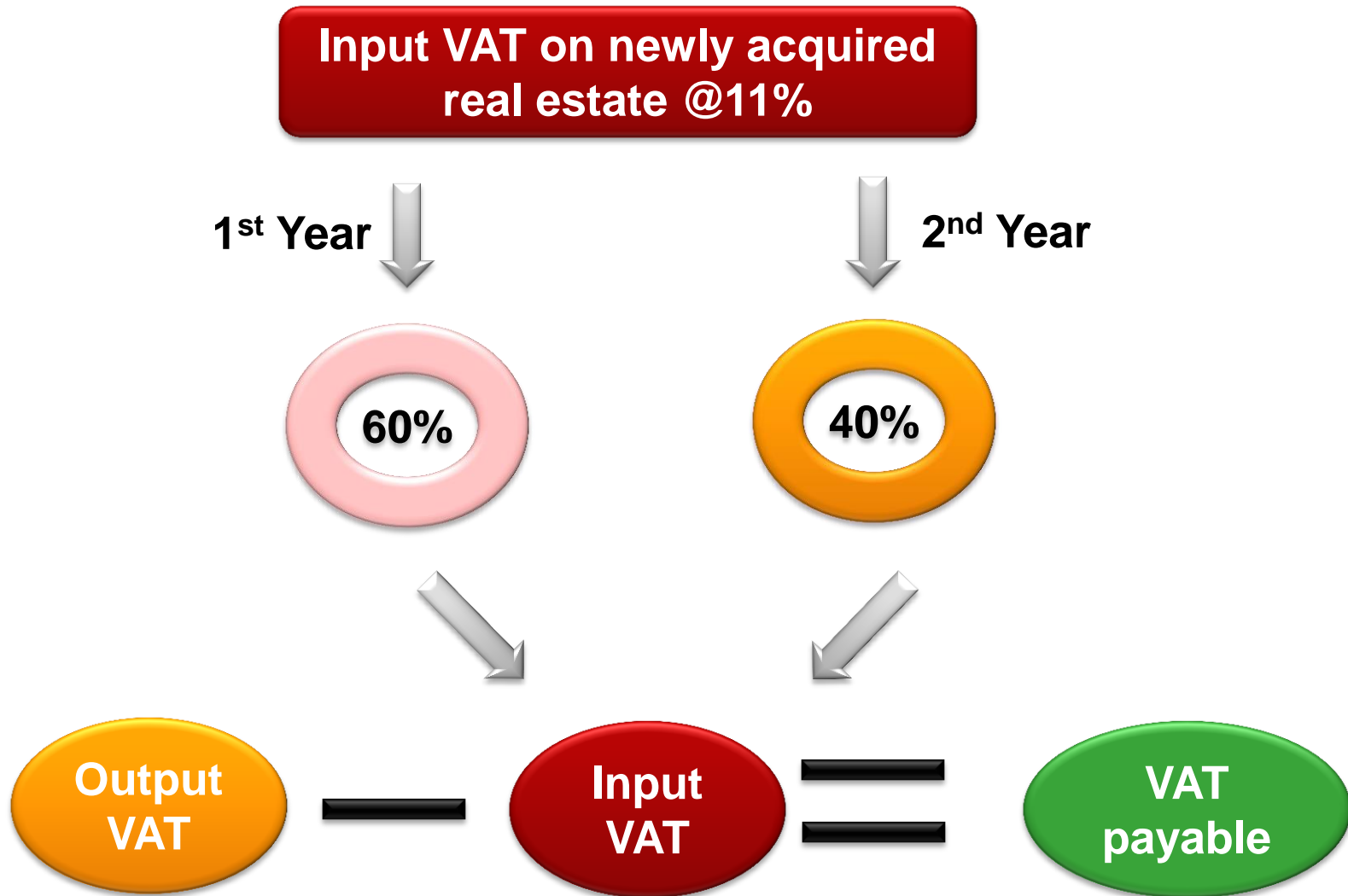
Calculation of VAT liability – General VAT Payer

Output-Input Method

VAT payable = Output VAT for the period – Input VAT for the period

- Output VAT = sales amount x applicable VAT rate
- Input VAT
 - Input VAT stated on VAT invoice obtained from suppliers or service providers
 - Input VAT stated on VAT payment certificate obtained from the Customs (upon importation)
 - Input VAT stated on tax payment certificate obtained from PRC tax authority / agent of the overseas service provider

Input VAT on Newly Acquired Real Estate



Non-creditable Input VAT

new

Immovable properties which incur abnormal loss, and the related goods purchased, design services, and construction services consumed for such immovable properties

Goods purchased, design services and construction services consumed for immovable property construction-in-progress which incurs abnormal loss

Passenger transportation services, loan services, catering services, resident daily services and entertainment services purchased

Calculation of VAT liability – Small-scale VAT Payer

Simplified VAT calculation method

- No credit for input VAT
- VAT payable = Taxable service amount x 3%



VAT Exemption

For example

- Trading income relating to the following financial products
 - Under Qualified Foreign Institutional Investor (“QFII”) scheme
 - Trading A-shares listed on the Shanghai / Shenzhen Stock Exchange through Shanghai / Shenzhen-Hong Kong Stock Connect by Hong Kong investors (including entities and individuals)
 - Trading of financial products by individuals
- Technology transfer and development and related technology consulting and technical services
- Transfer of immovable property or land use rights at no cost due to the division of family property

Export of services

Zero rate

- No output VAT
- Creditable input VAT
- VAT refundable

VS

VAT exemption

- No output VAT
- No creditable input VAT

Whereas, BT is not refundable for export services



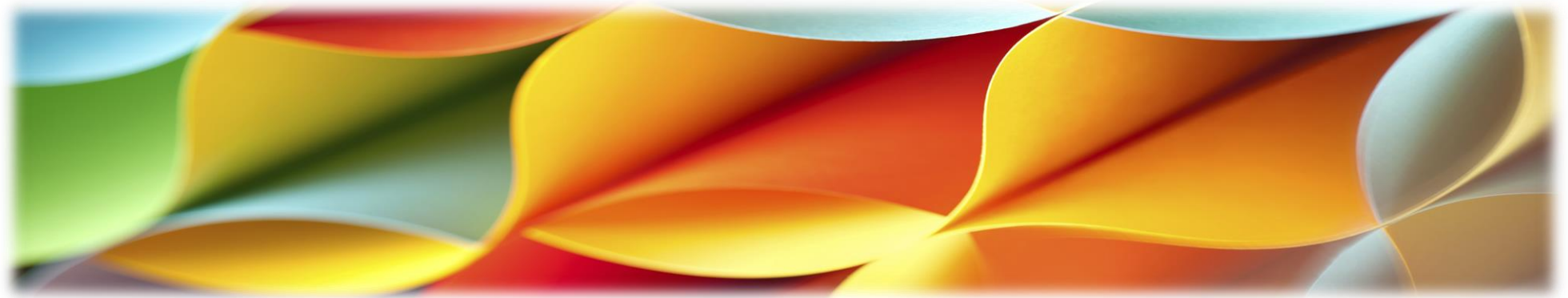
Export of services

Zero-rate

- International transportation services
- Space transportation services
- Services provided to overseas entities which are fully consumed outside of China
 - R&D
 - Design
 - Software
 - Information system service
 - Business process management
 - Technology transfer, etc.

VAT exemption

- Specified services rendered outside of China, such as construction, overseas conference and exhibition
- Postal services for exported goods
- Services and intangible assets provided to overseas entities which are fully consumed outside of China
 - Telecommunication
 - Intellectual property
 - Assurance and consultation
 - Business support, etc.



5. Case Illustration

Example of Real Estate Industry

The sales income of a real estate developer (general VAT payer) is RMB10 million (including VAT). The related land cost is RMB3 million. It has input VAT of RMB0.3 million.

Before B2V reform

$$\begin{aligned}\text{BT liability} &= \text{Sales} \times 5\% \\ &= 10\text{m} \times 5\% \\ &= \underline{\underline{0.5\text{m}}}\end{aligned}$$

After B2V reform

$$\begin{aligned}\text{VAT liability} &= \text{Output VAT} - \text{Input VAT} \\ &= (10 - 3) / (1 + 11\%) \times 11\% - 0.3 \\ &= 0.69 - 0.3 \\ &= \underline{\underline{0.39\text{m}}}\end{aligned}$$

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More questions?

Feel free to ask by email john.poon@mazars.hk or by phone +852 2909 5663