

Tax Analysis

PRC Tax

Authors:

Shanghai

Li Qun Gao, Partner
Tel: +86 21 6141 1053
Email: ligao@deloitte.com.cn

Candy Tang, Senior Manager
Tel: +86 21 6141 1081
Email: catang@deloitte.com.cn

Annie Chen, Manager
Tel: +86 21 6141 1157
Email: annichen@deloitte.com.cn

For more information, please contact:

Indirect Tax Services

National Leader

Hong Kong

Sarah Chin, Partner
Tel: +852 2852 6440
Email: sachin@deloitte.com.hk

Northern Region

Beijing

Yi Zhou, Partner
Tel: +86 10 8520 7512
Email: jchow@deloitte.com.cn

Eastern Region

Shanghai

Li Qun Gao, Partner
Tel: +86 21 6141 1053
Email: ligao@deloitte.com.cn

Southern Region

Guangzhou

Janet Zhang, Partner
Tel: +86 20 2831 1212
Email: jazhang@deloitte.com.cn

SAT issues guidance on application of VAT exemption treatment

China's State Administration of Taxation (SAT) issued a bulletin on 18 September 2013 (Bulletin [2013] No. 52) that provides nationwide implementation guidance for the application of VAT exemption treatment on qualifying cross-border services. Following the earlier Notice on the Pilot Tax Policies for the Nationwide VAT Reform in the Transportation Sector and Some Modern Service Industries (Caishui [2013] No. 37, "Circular 37"), Bulletin 52 focuses on the implementation of the VAT exemption. Bulletin 52 applies retroactively as from 1 August 2013, but also can apply to qualifying services provided before that date and for which the VAT exemption has not yet been applied. Under VAT exemption treatment, no output VAT is payable but the input VAT incurred on costs is not recoverable. Although less beneficial than zero-rated VAT treatment under which the input VAT incurred on cost is recoverable, VAT exemption is still considered as an incentive to promote the development of cross-border services. This guidance has been long awaited since it clarifies a number of practical issues.

Since the VAT reform pilot was launched in Shanghai in January 2012, the lack of the implementation guidance for the VAT exemption has created an obstacle for taxpayers to enjoy the exemption for cross-border services in accordance with Circulars 131¹ and 37. Since the SAT did not stipulate any nationwide guidance on implementation of the exemption, local practices varied and many taxpayers were unable to benefit from VAT exempt treatment in practice. This is because, in some cities, the local tax authorities did not accept the applicability of the VAT exemption and, in fact, required taxpayers to pay VAT; in other cities, the local tax authorities allowed taxpayers to apply the VAT exemption based on the taxpayer's own judgment. The local tax authorities in only a few cities (e.g. Shenzhen) issued local regulations on the relevant filing requirements for a VAT exemption.

The issuance of Bulletin 52 as national guidance should eliminate inconsistent local practices. However, the bulletin does not cover all eventualities and, thus, some issues still need further clarification and some local tax authorities have indicated that they are awaiting detailed guidance from the upper level tax authorities regarding the implementation of Bulletin 52. Although Bulletin 52 is a positive and welcome development, its successful implementation is open to debate.

¹ Circular Caishui [2011] No. 131 set out the general rules for VAT exemption treatment on qualifying cross-border services under the VAT reform program. The circular was superseded by Circular 37, but the rules on exempt services in Circular 131 were inherited by Circular 37.

Retroactive application of Bulletin 52

The most important feature of Bulletin 52 is its retroactive effect. Although effective from 1 August 2013, Bulletin 52 also applies to cross-border services provided before that date that qualified for VAT-exempt treatment. Therefore, if the VAT was collected on services that qualified for the exemption in the period from 1 January 2012 to 1 August 2013, in accordance with Bulletin 52, any overpaid tax can be refunded or offset against tax payable in the future. However, if a VAT special invoice had been issued, the VAT exemption will not be granted until all copies of those invoices are withdrawn and cancelled. The significance of the retroactive nature of the bulletin cannot be underestimated because it may provide an opportunity for a substantial refund of VAT charged in the past although this, in itself, raises commercial issues that would need to be addressed (e.g. withdrawn of VAT special invoices which have been used for credit of input VAT, refund to service recipients which previously reimbursed the output VAT charged, etc.). In addition, the following should be noted for services provided before 1 August 2013, the effective date of Bulletin 52:

- 1) If the VAT exemption was applied and the service remains within the scope of qualifying cross-border services, the taxpayer still must complete the filing requirements under Bulletin 52; and
- 2) If the VAT exemption was applied, but the service falls outside the scope of qualifying cross-border services, the underpaid VAT must be repaid to the tax authorities.

The retroactive nature of Bulletin 52 will be beneficial to many taxpayers where VAT had been charged in the past. The bulletin clarifies the filing requirements and confirms that overpaid VAT can be refunded or offset against tax payable in the future. Taxpayers that were required to charge VAT on exempt services should take steps to seek a refund in accordance with the above conditions.

Although the situation outlined in bullet 2) would be rare, it is possible in practice due to more detailed clarifications in Bulletin 52 on the scope of qualifying cross-border services and the re-determination of VAT treatment by the tax authorities. Bulletin 52 does not address whether there should be any late payment surcharge or penalties or how to handle the input VAT that has already been "transferred-out" because VAT exempt treatment was granted and applied.

New requirements to benefit from VAT exempt treatment

Bulletin 52 introduces some new requirements for a cross-border service to benefit from VAT-exempt treatment:

- The service provider must enter into a written contract with the service recipient;
- If the service was provided to overseas entities, all service fees must be collected from overseas; and
- The taxpayer must file for the exemption by submitting the contract and relevant documents to tax authorities.

In many instances, providing the necessary documentation will not be an issue. However, for some businesses (e.g. international freight forwarders), it may be administratively cumbersome to sign a contract for each order and hence the business works under a general master contract with the overseas recipient. In this case, it is unclear whether the tax authorities will accept a general framework contract for filing purposes or whether they will require a separate order or list of orders to be submitted.

Given that Bulletin 52 had been anticipated for so long, it is not as detailed as expected by many taxpayers (and local tax authorities). Some issues remain unresolved, such as whether a service will be deemed to be cross border and whether the VAT exempt treatment will apply when the service recipient in the contract is different from the service beneficiary and the service recipient is located outside China while service beneficiary is located within China.

Clarification of scope of tax-exempt cross-border services

Bulletin 52 clarifies the scope of cross-border services exempt from VAT (see the appendix for a full list of cross-border services exempt from VAT):

- *Broadcasting/distribution of TV and radio programs and films outside China:*
 - "Broadcasting outside China" refers to the broadcasting of TV and radio programs and films in cinemas, theatres and other places that are located outside China.
 - "Distribution outside China" refers to the distribution of TV and radio programs and films (including the transfer of the right to broadcast sporting events) where (1) such programs and films must be broadcast overseas; and (2) the recipient/buyer must be overseas entities or individuals.
 - Broadcasting to overseas audiences, but through domestic-located TV or radio stations, internet, satellite, etc. cannot be exempt from VAT.

- *Logistics ancillary services to overseas entities:* When a foreign international transportation company's vehicle stops at or transits through an airport, a harbor, highway station, airspace or waterway in China, the following services provided to the company by a domestic taxpayer may be exempt from VAT:
 - Aviation ground support;
 - Harbor services;
 - Goods/passenger station services;
 - Salvage and rescue; and
 - Goods loading, unloading and moving services.
- *Certification/attestation or consulting services to overseas entities:* Circular 37 introduced a rule according to which the VAT exemption will be unavailable if the certification/attestation or consulting services provided to overseas entities were related to goods in China. Bulletin 52 further clarifies that the test should refer to the physical location of the goods only when the services were provided.

Recommendations

Companies providing services to overseas customers should take the following steps:

- Review the nature of the services provided and identify whether they can qualify for VAT exemption treatment based on Bulletin 52;
- If so, collect necessary documents and apply for VAT exemption treatment;
- Review previous treatment (if applicable) and supporting documents to identify whether VAT should be refunded, repaid and/or whether any compliance procedures should be conducted;
- Proactively communicate with the in-charge tax authorities regarding the implementation in local practice;
- Explore options, such as business model restructuring, by separating VAT-exempt services from other services or businesses to maximize the VAT savings, etc.; and
- Consult with external tax experts if there is any question in the implementation.

Deloitte's Indirect Tax Team will continue to monitor the development of the VAT-exempt treatment. We can provide related tax advisory services and assist with communications with the tax authorities. If you have any questions, please feel free to contact us.

Note: Contents discussed in this Tax Analysis pertains to Deloitte Indirect Tax Services

Appendix - VAT-Exempt Cross-Border Services

1. Geotechnical investigations, surveying and exploration services for projects and mineral resources located outside China;
2. Conference and exhibition services (including relevant conference/exhibition management services) provided the conference and exhibition places are located outside China;
3. Warehousing services provided the storage sites are located outside China;
4. The leasing of tangible and moveable goods provided the leased object is used outside China;
5. Broadcasting and distribution of TV and radio programs and films outside China;
6. International transportation services (including transportation to/from/inside Hong Kong, Macau and Taiwan) that is not supported by an international transportation operation license;
7. The following VAT-able services if the simplified taxation method applies:
 - a. International transportation services (including transportation to/from/inside Hong Kong, Macau and Taiwan); and
 - b. R&D and design services provided to overseas entities (excluding design services relating to immovable property in China);
8. The following VAT-able services provided to overseas entities:
 - a. Technology transfers, technology consulting, energy performance contracting services (except services relating to a contract object located in China), software-related services, circuit design and testing services, information system services, business process management services, the transfer of trademarks and copyrights, intellectual property services, logistics ancillary services (excluding warehousing services), certification/attestation and consulting services (except services relating to immovable property located in China, or relating to goods located in China when the service was provided), production of radio, film and television programs, time/voyage charter in high seas transportation, aircraft wet leases; and
 - b. Advertising services for ads published outside China.

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Beijing

Kevin Ng
Partner
Tel: +86 10 8520 7501
Fax: +86 10 8518 7501
Email: keving@deloitte.com.cn

Hong Kong

Sarah Chin
Partner
Tel: +852 2852 6440
Fax: +852 2520 6205
Email: sachin@deloitte.com.hk

Shenzhen

Constant Tse
Partner
Tel: +86 755 3353 8777
Fax: +86 755 8246 3222
Email: contse@deloitte.com.cn

Chongqing

Claude Gong
Partner
Tel: +86 23 6310 6206
Fax: +86 23 6310 6170
Email: clgong@deloitte.com.cn

Jinan

Eunice Kuo
Partner
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068
Email: eunicekuo@deloitte.com.cn

Suzhou

Frank Xu / Maria Liang
Partner
Tel: +86 512 6289 1318 / 1328
Fax: +86 512 6762 3338
Email: frakxu@deloitte.com.cn
mliang@deloitte.com.cn

Dalian

Frank Tang
Partner
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297
Email: ftang@deloitte.com.cn

Macau

Quin Va
Partner
Tel: +853 8898 8833
Fax: +853 2871 3033
Email: quiva@deloitte.com.hk

Tianjin

Jason Wu
Partner
Tel: +86 22 2320 6680
Fax: +86 22 2320 6699
Email: jassu@deloitte.com.cn

Guangzhou

Constant Tse
Partner
Tel: +86 20 8396 9228
Fax: +86 20 3888 0121
Email: contse@deloitte.com.cn

Nanjing

Frank Xu
Partner
Tel: +86 25 5791 5208
Fax: +86 25 8691 8776
Email: frakxu@deloitte.com.cn

Wuhan

Justin Zhu
Partner
Tel: +86 27 8526 6618
Fax: +86 27 8526 7032
Email: juszhu@deloitte.com.cn

Hangzhou

Qiang Lu
Partner
Tel: +86 571 2811 1901
Fax: +86 571 2811 1904
Email: qilu@deloitte.com.cn

Shanghai

Eunice Kuo
Partner
Tel: +86 21 6141 1308
Fax: +86 21 6335 0003
Email: eunicekuo@deloitte.com.cn

Xiamen

Lynch Jiang
Partner
Tel: +86 592 2107 298
Fax: +86 592 2107 259
Email: ljiang@deloitte.com.cn

About the Deloitte China National Tax Technical Centre

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National Tax Technical Centre

Email: ntc@deloitte.com.cn

National Leader

Leonard Khaw
Partner
Tel: +86 21 6141 1498
Fax: +86 21 6335 0003
Email: lkhaw@deloitte.com.cn

Eastern China

Bill Ye
Partner
Tel: +86 21 6141 1261
Fax: +86 21 6335 0003
Email: bye@deloitte.com.cn

Northern China

Julie Zhang
Partner
Tel: +86 10 8520 7511
Fax: +86 10 8518 1326
Email: juliezhang@deloitte.com.cn

Southern China (Mainland/Macau)

German Cheung
Director
Tel: +86 20 2831 1369
Fax: +86 20 3888 0121
Email: gercheung@deloitte.com.cn

Southern China (Hong Kong)

Davy Yun
Partner
Tel: +852 2852 6538
Fax: +852 2520 6205
Email: dyun@deloitte.com.hk

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify Wandy Luk by either email at wanluk@deloitte.com.hk or by fax to +852 2541 1911.

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