

New Policies for Deepening the Value-added Tax ("VAT") Reform



Background

On 5 March 2019, Premier Li Keqiang proposed in the "Government Work Report" that the PRC's Government will implement larger-scale tax reduction policies and deepen the VAT reform. On 20 March 2019, Premier Li Keqiang chaired the Executive Meetings of the State Council and clarified the supporting measures for VAT tax reduction. On 21 March 2019, the Ministry of Finance, the State Taxation Administration and the General Administration of Customs jointly issued the "Announcement on Policies for Deepening the VAT Reform" (Announcement [2019] No. 39 of the Ministry of Finance, the State Taxation Administration and the General Administration of Customs) ("Announcement No. 39") and several guidelines in order to reduce the VAT tax burden.

Announcement No. 39 has come into effect on 1 April 2019. We set out below an overview and key measures of Announcement No. 39.

Overview of Announcement No. 39

1. Reduction of VAT rates

When VAT general taxpayers ("the taxpayers") carry out VAT taxable activities or imports goods, the applicable VAT rates have been reduced as follows: the original VAT rate 16% for relevant transactions is adjusted to 13%; the original VAT 10% for relevant transactions is adjusted to 9%; and the original VAT rate 6% for relevant transactions remains unchanged. Where there is a need to correct or issue an invoice for the taxable activities occurred before 1 April 2019, the invoice shall be issued according to the original applicable VAT rates and it is prohibited to apply the new VAT rates.

2. Reduction of export refund rates

In line with the reduction of VAT rates, the PRC enterprise export refund rate and the overseas visitors purchase refund rate upon their departure have been reduced accordingly as following: -

	Adjusted refund rate
Exported goods and relevant service which are originally subject to 16% VAT rate and 16% export refund rate	Export refund rate is adjusted to 13%
Exported goods and cross boarder taxable activities which are originally subject to 10% VAT rate and 10% export refund rate	Export refund rate is adjusted to 9%
The goods purchased by overseas visitors which are subject to a 13% refund rate	Refund rate is adjusted to 11%
The goods purchased by overseas visitors which are subject to a 9% refund rate	Refund rate is adjusted to 8%

Please note that if the taxpayers had paid the VAT based on the original VAT rate before 30 June 2019, the original refund rate shall apply; if the taxpayers paid the VAT based on the new VAT rate, the new refund rate shall apply.

Overview of Announcement No. 39

3. Reduction of agricultural products' deduction rate

For agricultural products purchased by taxpayers, the new deduction rate is adjusted to 9% from the original rate 10%. For agricultural products purchased by taxpayers for production or outsourced processing which are subject to VAT at 13%, a 10% deduction rate shall apply when calculating input VAT.

4. One-off deduction of input VAT arising from the acquisition of immovable property or project under construction

Taxpayers no longer need to claim their input VAT credit for purchasing immovable property or project under construction over 2 years. All relevant input VAT can now be deducted in the relevant tax period. Before the commencement of Announcement No. 39, if there is any input VAT not yet fully deducted, it can be used to offset the output VAT in the relevant tax period starting from April 2019.

5. Input VAT for purchase of domestic passenger transportation services

Announcement No. 39 has revised the relevant provisions in the previous VAT regulations for "certain types of services whose input VAT cannot be claimed", and stipulates that if the taxpayers purchase "domestic passenger transportation services", the input VAT arising from such services can be used to offset the taxpayers' output VAT.

If the taxpayers obtain VAT electronic general invoices or VAT special invoices, the input VAT shall be the VAT amount indicated on the invoices; if taxpayers obtain documents which state the passenger's identity information including air transport e-ticket, railway tickets, road or waterway ticket and etc., the input VAT shall be calculated by the VAT inclusive price on such documents and applicable VAT rates.

Overview of Announcement No. 39

6. Super deduction of input VAT for several industries

From 1 April 2019 to 31 December 2021, taxpayers engaged in production or livelihood related services will be granted a 10% super deduction of input VAT to offset their VAT payable ("Super Deduction Policy").

Applicable scope: "taxpayers engaged in production or livelihood related services" refers to any taxpayers which earn more than 50% of their total sales revenue by providing postal service, telecommunications service, modern service or lifestyle service. The specific rules are as follows:-

1. For those taxpayers incorporated before 31 March 2019, if the sales amount from April 2018 to March 2019 meets relevant requirement (if the operation period is less than 12 month, the actual sales amount is regarded as the sales amount), the Super Deduction Policy shall apply since 1 April 2019.
2. For those taxpayers incorporated after 1 April 2019, if the sales amount since incorporation meets relevant requirement, the Super Deduction Policy shall apply from the date of registration to be a general VAT taxpayer.
3. Once the taxpayers confirm to apply the super deduction, no adjustment shall be made in the current year, and their eligibility for the super deduction in the following year should be determined based on its sales amount of the preceding year.

A taxpayer should make the super deduction in the current period at 10% of the current period's creditable input VAT. No super deduction shall be calculated for non-deductible input VAT according to the prevailing regulations. If the input VAT is transferred out as required, the super deduction related to such amount of input VAT should also be reduced accordingly in the current period.

The formula of calculating the super deduction is as below:

Super deduction provision in the current period = creditable input VAT in current period *10%

**Super deduction amount deductible in the current period =
balance of super deduction at the end of the previous period + super deduction provision in the
current period – super deduction amount reduction in the current period**

Overview of Announcement No. 39

7. VAT refunds for excess input VAT

The pilot system for refunding the excess input VAT credits has taken effect on 1 April 2019. A taxpayer who meets all of the following criteria may apply for the refund of its incremental excess input VAT:

1. From the tax period since April 2019, the incremental excess input VAT for each of the six consecutive months (two consecutive quarters if taxed quarterly) is a positive amount, and the incremental excess input VAT credits in the sixth month is not less than RMB 500,000 ;
2. The taxpayer's taxation credit ranking is rated as Grade A or Grade B;
3. The taxpayer has not committed fraud for excess input VAT refund, export refund or falsely issued special VAT invoices for 36 months before its claim for the VAT refund;
4. The taxpayer has not been penalized by tax authorities for tax evasion matters for two or more times within 36 months before its claim for the VAT refund; and
5. It has not enjoyed the policy of VAT refund under the refund-upon-levy or refund-after-levy since 1 April 2019.

The formula of the refundable amount regarding incremental excess input VAT in the current period is as follows:

Refundable incremental excess input VAT = incremental excess input VAT × the proportion of input VAT × 60%

Proportion of input VAT refers to the proportion of VAT indicated in the special VAT invoices (including the machine-printed uniform invoices for motor vehicle sales) that have been credited, special VAT payment forms issued by Customs for import and tax payment receipts from April 2019 until the preceding tax period of the claim for VAT refund, over all input VAT that has been credited in the same periods.

For the export of goods and labor services or cross-border taxable activities carried out by a taxpayer, to which the measures for VAT "exemption, credit and refund" are applicable, the taxpayer could apply for the refund of the excess input VAT credits given that it still meets the criteria specified in Announcement No. 39 after completing the formalities for VAT "exemption, credit or refund"; if the measures for VAT "exemption and refund" are applicable, the relevant input VAT should not be used for the refund of excess input VAT.

PKF Comments

Tax reduction is the key reform direction of the PRC's financial department in recent years. The deepening VAT reform policy this time focuses on reducing the VAT rates of certain industries such as manufacturing, transportation, construction and basic telecommunications services, but it does not reduce the 6% VAT rate applicable to the service industry. We view that it is possible for the PRC government to simplify the three-level VAT rates in the future in order to achieve the simplification of taxation system. It is unlikely that the 6% VAT rate will be reduced in the following years, but there is still room for simplification of the three-level VAT rates after this reform. The reduction of the tax rate would significantly reduce the tax burden of intermediate flows of goods or services, and would lay the foundation for the government's macroscopic policy of reducing tax burden.

Taxpayers should focus on the effective date of the VAT reform policy. Since the timing when the VAT obligation arises may not be consistent with the timing of revenue recognition, if the taxpayers can determine the timing of VAT obligation and the applicable VAT rates more accurately in advance, they should be able to mitigate relevant tax risks in a reasonable manner.

The VAT reduction policies (including the pilot system of VAT refunds for excess input VAT) under Announcement No. 39 can effectively increase taxpayers' cash flow, reduce taxpayers' operating costs and create larger profit margins for taxpayers. Taxpayers should make proper preparations for the above preferential policies to ensure that they can fully enjoy the preferential tax policies by evaluating their situation, improving the internal control system and performing reasonable tax planning.

Moreover, the VAT reduction policies this time are also in line with the internal trend of reducing tax burden. From the domestic perspective, we view that the tax reduction policies would be beneficial to the development of PRC's economy and cross-border trading, and would be able to attract more foreign investment in the PRC.

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