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NEWS

The impact of VAT on your business in China

Defining your strategy and analysing the market are crucial when making the decision to invest in China, but the tax efficiency of the business has its own specific issues and investors should not neglect them either.

The Chinese tax system has particular characteristics that you must get to know before investing.

In this informative note, we will address some basic aspects of value added tax and the invoicing system. However, it will always be necessary to go into much more detail and to consult a specialist in each individual case.

Value added tax (VAT) and the invoicing system known as fapiao are two of the main sources of revenue for the Chinese government.

China is attracting more and more foreign investors as it continues to enjoy above-average levels of growth, even in pandemic situations such as the one triggered by COVID-19.

VAT is a tax that applies to a range of services in China, such as the sale purchase and of goods, manufacturing and repair services, the import and export of goods to and from China and, in general, all transaction-related services. The rates may vary depending on the taxpayer's sales revenues, the type of goods and the sector.

To implement greater transparency in the system and to combat tax evasion, the Chinese government has created an invoicing mechanism capable of controlling/registering all transactions.

Thus, in deciding to set up a company in China and to opt for the most common type of limited liability company, your company will have the tax status of a "small-scale taxpayer" and will be prevented from offsetting VAT on expenses. However, if the company achieves a certain turnover (as a rule around RMB 800,000 over one tax year), it can claim or offset the VAT on purchases of goods and services. Moreover, the company must then be classified as a "general taxpayer".

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Invoicing of RMB 800,000 per year is the limit set for most cities in China, but this amount may vary, so it is essential to confirm in advance the amount applicable in the city where the company is registered.

For taxpayers with general status, VAT is paid monthly, while for small-scale taxpayers, VAT must be paid quarterly.

On 1 April 2019, the VAT rate applicable to taxpayers with general status was reduced and currently stands at 13%, which is the standard VAT rate for the sale of goods and services.

However, this rate is reduced to 6% for specific activities such as financial services, insurance, telecommunications, Internet, technology and consultancy.

The rate is 9% for retail trade, entertainment services, hotels, restaurants, catering services, real estate and construction, the post office, transport and logistics.

Alongside this reduction in VAT rates, there have also been reforms to cut red tape in tax operations and procedures.

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Currently, a company with small-scale taxpayer status can have its status changed to that of general taxpayer within only 2 to 5 working days of submission of the application. Previously, the estimated time for approval was two months.

Companies with sales of less than RMB 100,000 per month are exempt from paying VAT, but they are required to issue invoices.

An invoice (translated from Mandarin as fapiao) is a receipt issued by the Chinese Taxation Administration (but provided by the seller) which serves as proof of the purchase of goods or services. The fapiao system is an essential component of tax legislation in China and all companies are required to comply with it. Importantly, it allows the government to monitor tax payments and deter tax evasion.

This system of invoicing for companies is monitored very strictly and companies are required to keep receipt/invoice books safely so that they are not used illegally in the parallel (black) market. Protecting receipt books in safes has become common practice in China and the Taxation Administration can inspect the company to make sure that the receipt books are being kept properly and that there are no "lost" invoices. If a tax inspection finds any irregularities in the receipt books, the authorities can impose a fine of up to RMB 10,000 on the company.

There are two types of invoices in China:

- The general invoice which is a simple proof of payment; and

- The special invoice used for tax deduction purposes, which contains detailed information on the goods and services subject to the transaction, including the trader's tax number, the address, telephone number and bank account details.

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As invoices are the documents that prove transactions carried out in China, companies cannot refuse to issue invoices. Any refusal to do so is a serious offence.

The invoice books (with an amount per invoice that can vary) are distributed by the Taxation Administration according to the amounts of the operation communicated by the taxpayer company. For this purpose, the company must specify to the Taxation Administration the type of transactions and the turnover it estimates to generate each year.

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The system of invoicing, deduction and payment of VAT operates almost automatically and is controlled by the Chinese Taxation Administration. There is also the possibility for companies to acquire software equipment and a printer to issue invoices and even hire an accountant trained by the local Taxation Administration to expedite all these procedures.

The invoicing system in China can be complex for foreign companies doing business there. This is why it is so important to know the procedures and requirements, to act accordingly and thus make your business more efficient. ■