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# Risks related to input VAT claims

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## In brief

» Input VAT claims can easily pose significant tax compliance risk, especially to companies newly put under the VAT regime due to the VAT reform.

» Due attention should be paid to cases in which input VAT credits are disallowed.

## In detail

In reinforcing VAT compliance, one of the key tasks is ensuring input VAT credits are claimed properly per the VAT legislation. It is important to understand the restrictions on input VAT credit claims. Improper claims can be a serious tax compliance issue, and can lead to penalty.

We summarize below six cases in which input VAT credits cannot be claimed due to the VAT reform:

### 1. Input VAT recorded in accounting system

VAT compliance relies much on an effective accounting system which is expected to be able to record accurate input / output VATs and VAT payables per accounting and tax regulations. A draft regulation on VAT related accounting treatments has been issued on 4 July 2016, which is in its public consultation period and will require VAT payers to set up additionals subsidiary accounts to cope with new treatments due to the VAT reform. Although the new regulation is not yet enacted, it can be foreseen that detailed accounting record will be a prerequisite to accurate VAT filings.

### 2. Input VAT with supporting documents

VAT regulations requrie that input VAT credits can be supported by documentation. Otherwise input VAT credits cannot be claimed. Documentation can vary from transaction to transaction. In general, the documentation includes special VAT invoices, import VAT payment certificates, purchase invoices for agricultural products and tax receipts, etc. In the case of payments from China to overseas incurring VAT withholding, a complete set of documentation is required, including tax receipts, contracts, payment certificates and invoices.

### 3. Input VAT related to abnormal losses

Abnormal losses refer to losses resulting from theft, impairment or deterioration due to poor management, confiscation, destruction or demolition of goods or immovable by law enforcement bodies.

Input VAT related to abnormal losses in the following cases cannot be claimed:

- Inventory losses (including related processing, repair and assembly and transportation);
- Work-in-progress or products losses (including related purchases, processing, repair, assembly and transportation);
- Immovable losses (including related purchases, design and construction); and
- Immovable-related work-in-progress losses (including related purchases, design and construction).

### 4. Input VAT in final consumption

Input tax credits cannot be claimed for purchases used in final consumption listed below:

- Goods, assets and services used for collective welfare or personal consumption;
- Interest expense for loans and financial sell-and-lease-back, financial advisory fee, handling fee and consultancy fee related to loans;
- Entertainment services, catering services and daily living services, as summarized below.

| Services | Tax category | VAT rate | Input VAT credit? |
|---|---|---|---|
| Dine-in service | Catering services | 6% | No |
| Cosmetology and hairdressing | Daily living services | 6% | No |
| Singing / dancing ballrooms, bars, bowling | Entertainment | 6% | No |
| Pick-up services | Passenger transportation | 6% | No |

**5. Input VAT in simplified VAT filing, non-VAT or VAT exempted operations**

For companies which have opted to use the simplified VAT filing method or have enjoyed the non-VAT or VAT exemption treatments, their input VAT credits cannot be claimed.

**6. Input VAT in VAT filings based on net income**

For some services such as financial leasing, air transportation, brokerage and toursim etc. which are allowed to file VAT using the net-income method (i.e. Certain prescribed expenditures being deducted from gross sales amount for VAT calculation), they cannot claim input VAT for such operations.

## WTS observation

Taxpayers should pay special attention to their claims of input VAT credits. Systematic review and training should be considered to ensure a VAT compliant practice.

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