

2016/08

April 2016

## 10 tips to manufacturing operators – B2V reform

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#### In brief

- » China's Premier, Mr. Li Keqiang, announced the extension of business tax-to-VAT (B2V) reform to the remaining four sectors: construction, real estate, financial services and lifestyle services starting from 1 May 2016.
- » The Ministry of Finance (MoF) and the State Administration of Taxation (SAT) have jointly released Caishui [2016] No.36 (Circular 36) for the final stage of the B2V reform, effective from 1 May 2016.
- » Upon completion of the VAT reform, BT will become a history.
- » Manufacturing entities, which have close business relationship with these four sectors will also be affected by this last round B2V reform.

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**In detail**

In accordance with Circular 36, construction, real estate, financial services and lifestyle services (four sectors) will be transitioned from business tax to VAT regime starting from 1 May 2016. Although manufacturing is not in the four sectors, it often deals with the said four sectors and will be affected by the last round of the B2V reform.

Some ten tips are offered below as practical examples why manufacturing operators should pay attention while dealing with these four sectors after 1 May 2016:

- **Tip 1 – Amend pricing structure (concurrent vs. mixed sales)**

Check if you need to restructure your pricings if a sale of good contract contains also services which are subject to different VAT rates. If the VAT-able activities are not separately accounted for, the highest VAT rate would apply to all VAT-able activities.

- **Tip 2 – Clarify withholding VAT obligation**

Clarify if the services you have used are taking place outside China, or if the intangibles you have purchased and the movable tangible assets you have leased from overseas suppliers are exclusively used outside China. If this is the case, there is no China VAT obligation for the overseas suppliers and you do not need to withhold China VAT on behalf of them. Otherwise, you will be the VAT withholding agent.

- **Tip 3 – Collect complete documentation for withholding VAT credit**

Collect the complete set of documentation for your overseas purchases, including tax payment receipts, contracts, payment certificates and invoices for claiming withholding VAT credit against the output VAT. If the documents are incomplete, the withholding VAT cannot be credited against your output VAT.

- **Tip 4 – Check the benefits for financial services purchased**

Maximize your input VAT credit claim for any creditable financial services used after 1 May 2016. For example, VAT costs on those bank charges with no relation to loan services can be your input VAT credit, i.e. bank charges, bank account management fee, consulting fee on services of letters of credit, etc. and property insurance services.

Otherwise, if you rely heavily on loan financing, you may not be able to enjoy much input VAT credit, since loan related VATs are not creditable. For example, interest expense for loans and financial sell-and-lease-back, financial advisory fee, handling fee and consultancy fee related to loans.

- **Tip 5 – Claim input VAT credit for commercial real estate purchased**

You may consider delaying slightly any purchase of commercial premises (factory buildings, e.g.) or work-in-progress premises until after 30 April 2016, if you have such a plan recently, since the input VAT incurred after this date can be credited against the output VAT over a two-year period, with 60% of the input VAT credited in the first year and the remaining 40% credited in the second year.

Check whether your sellers adopt a simplified VAT method with 5% VAT rate or a general VAT method with 11% VAT rate to tax you, when you purchase any commercial real estate obtained or self-built by the sellers before 30 April 2016. Your input VAT credit amount will be affected by their VAT position. The latter (11% VAT rate) is better because it is creditable to you.

- **Tip 6 – Claim input VAT credit for commercial real estate leased**

You should obtain special VAT invoices from your landlord for any premises leasing after 1 May 2016.

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Check whether your landlord adopts a simplified VAT method with 5% VAT rate or a general VAT method with 11% VAT rate to tax you, when you lease an existing commercial real estate obtained by the landlord before 30 April 2016. Your input VAT credit amount will be affected by their choice.

- **Tip 7 – Claim input VAT credit for construction services purchased**

Claim input VAT credit for a work-in-progress (WIP) project lasted after 1 May 2016, including building, rebuilding, enlarging, renovating or decorating your factory / plant / office. The input VAT incurred can be credited against output VAT over a two-year period, with 60% of the input VAT credited in the first year and the remaining 40% credited in the second year.

Check whether the builder adopts a simplified VAT method with 3% VAT rate or a general VAT method with 11% VAT rate to tax you, if the commencement date of construction contract for WIP project is prior to 30 April 2016. Your input VAT credit amount will be affected by their choice.

- **Tip 8 – Claim input VAT credit for lifestyle services purchased**

Claim input VAT credit for lifestyle services purchased after 1 May 2016. For example, accommodation services, cultural and sports services, education and medical services, tourism services, etc.

VAT costs on entertainment, catering and resident daily services are not eligible for input VAT credit.

- **Tip 9 – Maximize input VAT credit claim for other services purchased**

Claim input VAT credit for other services purchased. For example, VAT costs incurred in using authentication and consultation services, enterprise management services, brokerage services, HR services, security and protection services, real estate agency and job agency, etc. are creditable input VAT from 1 May 2016.

VAT costs on flight tickets and train tickets purchased during business trips are non-creditable.

- **Tip 10 – Claim VAT zero-rate / exemption for eligible outbound transactions**

Check if you can enjoy zero VAT rate or VAT exemption for eligible outbound transactions. For example, you can enjoy zero VAT rate if providing R&D service, design service, software service and etc. to overseas entities and fully consumed outside of China; you have the chance to enjoy VAT exemption if leasing out tangible movables which are used overseas. Do obtain the required documents from your overseas customers for filing with China tax authority to enjoy the VAT exemption.

## WTS observation

Manufacturing operators should review the impacts on their business caused by the last round of B2V reform including:

- Note the taxable services which allow you to claim input VAT credit.
- Confirm whether your suppliers adopt a simplified VAT method or a general VAT method to tax you, when purchasing / leasing a commercial real estate or purchasing the construction services.
- Obtain valid invoices in a timely manner to claim input VAT credit.
- Review the timing of purchasing and the selection of vendors.

Review the new contracts issued by your suppliers regarding whether they transfer their output VAT to you, e.g. who will bear the output VAT and whether the total contract value include the VAT amount.

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