

China Tax and Business Newsflash – 2012 No. 1



Value-added Tax Pilot Reform in Shanghai:

Clarification on the Treatment of Outbound Service Provision

Background

Subsequent to the issuance of circulars Caishui [2011]110 (“Circular 110”) and Caishui [2011]111 (“Circular 111”) by the Ministry of Finance (“MOF”) and State Administration of Taxation (“SAT”) for implementing the pilot Value-added Tax (“VAT”) reform in Shanghai from January 1, 2012, MOF and SAT have recently published circular Caishui [2011]131 (“Circular 131”). Circular 131 clarified the VAT treatment on Chinese enterprises’ provision of relevant services to overseas entities.

Key Points of the Circular

- According to Article 2.2.4 of Circular 110, outbound provision of relevant services is subject to the zero VAT rate or is exempted from VAT. However, according to Articles 1 and 10 of Circular 111, Chinese enterprises and individuals providing the relevant services “in China” are subject to VAT. The service is regarded as being provided “in China” if the service provider OR the service receiver is in China. According to the latter, if a Chinese company provides the relevant services to an overseas company, it seems that the services will be regarded as being provided “in China” and thus should be subject to VAT. It seems that Circular 110 and Circular 111 are not consistent on the VAT treatment of outbound VAT provision. In this regard, Circular 131 clarified that:-
- Companies and individuals in the pilot areas that provide the following services to overseas entities are applicable to the zero VAT rate:-
 - International transportation services (the relevant companies should have obtained the required operation licenses)
 - R&D services provided to overseas entities
 - Designing services provided to overseas entities (excluding the designing services related to the real properties situated in China)
- If a company’s outbound provision of relevant services is applicable to the zero VAT rate and if such company is a VAT general tax payer, it can enjoy the VAT

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“Exemption, Credit and Refund” (“ECR”) treatment. Its VAT refund rate on the relevant services equals to its applicable VAT rate on such services. Monthly ECR filings should be conducted with the in-charge tax authorities. Detailed implementation rules will be published by SAT (after consulting MOF).

- Companies and individuals in the pilot areas that provide the following services to overseas entities are exempted from VAT, except for the services mentioned above that are applicable to the zero VAT rate:-
 - Exploration services for the projects and mines situated outside China
 - Services for the conventions and exhibitions held outside China
 - Warehousing services for the goods stored outside China
 - Leasing of movable goods used outside China
 - International transportation services provided by a company that has not obtained the relevant operation license
 - Relevant services provided to overseas entities, including technology transfer, technology consulting, contracted energy management, software services, IC designing and testing, IT services, business process management, trademark and intellectual property transfer, supporting logistics services (excluding warehousing), verification, assurance, consulting, advertising (if the advertisement is published outside China), excluding contracted energy management services relating to the target assets in China, verification/assurance/consulting services relating to the goods or real properties in China

Potential Impact on Your Company

- According to Circular 131, if your company provides the above services to overseas entities, your company will be applicable to the zero VAT rate or the VAT exemption treatment. In other words, there will be no output VAT on your company’s relevant service fee income.
- If your company’s provision of the relevant services to overseas entities is applicable the zero VAT rate, the full amount of relevant input VAT can be credited or refunded.
- If your company’s provision of the relevant services to overseas entities is exempted from VAT, then the relevant input VAT needs to be transferred out and absorbed as cost. In this regard:-

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- If the amount of input VAT related to the services like consulting service is not significant, the impact of input VAT transfer-out will be immaterial.
- If your company has both VAT exemption items and zero rate items, or non VAT-taxable items, then the relevant input VAT needs to properly separated (on an actual basis or according to the formula stipulated in Article 26 of Circular 111). This can be a challenge to your company, but might also be an opportunity.
- If the services provided by your company are in the scope of zero VAT rate or VAT exemption, then if commercially feasible, your company may improve the tax efficiency if contracting with and receiving payment from an overseas entity of your client, compared with contracting with and receiving payment from a Chinese entity of your client.
- Your company' outbound provision of the relevant services generally was subject to 5% Business Tax ("BT"). Due to the VAT pilot reform in Shanghai, your company's tax cost will reduce (changed from a BT item to a VAT item, no output VAT, and possible input VAT credit/refund). Therefore, your company will be able to offer a more competitive price to promote overseas clients.
- If your company belongs to a multi-national corporation ("MNC") group, when your group selects its regional management or service provision center, it should now consider the impact of Circular 131 and assess the comparative tax advantage of your company (assuming it is a Shanghai company) of acting as such center. For example, if your company is a China Holding Company or a Regional Headquarter set up by a MNC group, then your company now has more tax advantage to provide the above services to affiliates in other countries or regions than before. If so, your group may re-consider its regional or even global plan of relevant subsidiaries' function allocation.

What Texel Consulting/ThinkBridge CPAs can Help:

Regarding the issues discussed in this China Tax and Business Newsflash, Texel Consulting can help your company on the following aspects:-

- Analyze whether your company's outbound provision of the relevant services is in the scope of VAT zero rate or VAT exemption according to Circular 131
- Assist your company to apply with the in-charge tax bureau to confirm the above VAT zero rate or VAT exemption treatment on the outbound provision of the relevant services

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- Analyze the VAT and other tax/finance impact of the outbound provision of services and your company or your group's function re-allocation of various affiliates
- Assist your company to conduct monthly VAT refund filings (if applicable to zero VAT rate)

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Important Note

The contents in this China Tax and Business Newsflash are for your reference purpose. Readers are suggested to consult professional advisors for detailed analysis before implementation. For more information or further advice on the above subject or analysis of other tax/business issues, please feel free to contact our tax partners based on the following contact information:-

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