



Tax Analysis

China

Deloitte Tohmatsu Tax Co.

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New Rules Issued on the Administration of VAT Exemption for Cross-border Taxable Activities

China's State Administration of Taxation (SAT) issued guidance (Bulletin [2016] No. 29 (Bulletin 29)) on 11 May 2016 that clarifies the administration of the VAT exemption for cross-border taxable activities. VAT exemption could be beneficial to taxpayers because no VAT will be charged on such activities. However, unlike zero-rated treatment, input VAT attributable to VAT exempt activities cannot be credited or refunded.

China's VAT fully replaced the business tax on 1 May 2016, with the inclusion of the last four sectors (i.e. construction, real estate, financial services and lifestyle services) within the scope of VAT; VAT now applies across the country to all sectors of the economy. The main guideline for the VAT pilot reform, Circular Caishui [2016] No. 36 (Circular 36), contains general guidance on the VAT exemption for cross-border services. Bulletin 29 now provides detailed administration rules on the exemption, as well as guidance on the registration process and the responsibilities of both taxpayers and the tax authorities in relation to the VAT exemption. Like Circular 36, Bulletin 29 is effective from 1 May 2016, and it supersedes the previous VAT exemption administration rule found in Bulletin [2014] No. 49, which is repealed from the same date.

(1) Highlights of Bulletin 29

1) Conditions to qualify for VAT exemption

Chinese entities and individuals carrying out cross-border taxable activities must satisfy all of the following conditions to qualify for VAT-exempt treatment:

- The activity must fall within the scope of the 20 activities listed in Bulletin 29 (see appendix);
- The taxpayer must conclude a written contract with the counterparty for the supply of the cross-border services or intangible assets (except for activities 9 and 20); and
- Where the taxpayer supplies services or intangible assets to overseas recipients, the income derived therefrom must be received from overseas (note, however, that certain types of income are deemed to be received from overseas).

The 20 types of activities eligible for a VAT exemption can be classified into six categories (see appendix):

- A. Cross-border taxable activities that take place outside China;
- B. Services provided for exported goods;
- C. Services and intangible assets sold to overseas entities and wholly consumed outside China;
- D. Certain financial services;
- E. Certain international transportation services; and
- F. Taxable activities that are eligible for VAT zero-rated treatment, but for which the taxpayer pays VAT under the simplified method or has elected to relinquish zero-rated treatment and instead opt for VAT-exempt treatment.

2) Registration procedure

Bulletin 29 generally retains the previous rules regarding registration, i.e. taxpayers that engage in cross-border VAT-exempt activities are required to complete a registration procedure to enjoy the VAT exemption. If there are changes to the original contract or the relevant facts, but the taxpayer still qualifies for a VAT exemption, re-registration is required.

a) Required documents

The following documents must be submitted to the tax authorities when a taxpayer is carrying out the registration procedure for VAT-exempt treatment:

- Registration form for cross-border taxable activities;
- Contract for cross-border sales of services and intangible assets;
- Supporting documents to prove that the services are provided outside China (if applicable);
- Supporting documents to prove that the purchasing entity is located outside China (if applicable); and
- Declaration relinquishing zero-rated treatment (if applicable).

If the original contract is not in Chinese, the taxpayer must provide a Chinese translation signed by the supplier's legal representative (or in-charge personnel) or be affixed with its chop.

Bulletin 29 requires that the above documents be retained after the registration procedure is completed (although the bulletin does not specify any period for retention). If the taxpayer cannot provide the documents upon the request of the tax authorities, the taxpayer will not be entitled to enjoy the exemption and will be required to repay the exempt amount.

b) Late registration

Registration generally must be carried out at the time the taxpayer files for VAT-exempt treatment for the first time. However, Bulletin 29 retains the previous rules that a late registration will not disqualify a taxpayer for exempt status, although administrative penalties may be imposed for the late registration. If the taxpayer has not requested a VAT exemption and has paid VAT on activities qualifying for the exemption, once the registration procedure is completed, the taxpayer can request a refund of the VAT paid or request an offset of the VAT paid against future VAT payable; since special VAT invoices are not allowed to be issued for VAT-exempt activities, the supplier should request that the purchaser return all special VAT invoices that were issued in such situations before the taxpayer initiates the VAT exemption

registration procedure.

c) Rights and responsibilities of the tax authorities

According to the "Administration Rules Relating to Tax Reductions and Exemptions" (SAT Bulletin [2015] No. 43), Bulletin 29 provides detailed guidance on the rights and responsibilities of the tax authorities.

- ◆ The following situations should be treated according to the Tax Collection and Administration Law, and the tax authorities are empowered to pursue any underpaid tax and/or impose penalties:
 - The taxpayer does not qualify for a VAT exemption based on the actual facts;
 - The taxpayer obtains an exemption through fraudulent means;
 - The taxpayer fails to report to the tax authorities where there is a change in its qualifications for the exemption; and
 - The taxpayer claims an exemption without performing the relevant registration procedure.
- ◆ Different treatment will apply depending on the status of the application documents submitted by the taxpayer for a VAT exemption:
 - If there are errors in the registration documents, the tax authorities should notify the taxpayer and allow the taxpayer to make a correction;
 - If the registration documents are incomplete or not in the required format, the tax authorities should advise the taxpayer of all requirements for the taxpayer to make a correction; and
 - If the registration documents are complete and in conformity with the required format, or if the taxpayer has amended its registration documents based on a request by the tax authorities, the authorities must accept the registration and return the original version to the taxpayer; and
 - If the amended registration documents still fail to meet the requirements of the tax authorities, the authorities should reject the registration and return all documents to the taxpayer.

In all cases (i.e. regardless of whether a registration is accepted or rejected), the tax authorities must issue a written statement that is dated and affixed with the tax authorities' chop.

(2) Deloitte's Comments

Bulletin 29 further clarifies the administration of the VAT exemption for cross-border taxable activities, especially with respect to qualifying for the exemption. This should help improve certainty in the implementation of the rules. However, Bulletin 29 does not clarify certain concepts or address controversies related to such issues in practice. For example, to prevent a domestic transaction from being disguised as a cross-border transaction so that it qualifies for the VAT exemption, Circular 36 introduced the concept of "wholly consumed outside China," which is further defined to encompass the following scenarios:

- The actual recipient of the services is outside China and the services are not related to goods or real property in China;
- The intangible assets are used entirely outside China and are not related to goods or real property in China; and
- Other situations specified by the Ministry of Finance and the SAT.

In practice, when consulting services are provided to multiple related parties, if the deliverable (e.g. a consulting report) is provided simultaneously to related entities located both within and outside China, will the domestic entity receiving the deliverable be viewed as the actual recipient of the service and thus disqualify the entire service for the VAT exemption? This still needs to be clarified.

Similarly, when assessing whether a cross-border service transaction qualifies for a VAT exemption, questions arise as to whether the service is related to goods or real property in China. For example, where marketing and consulting services are provided by a Chinese entity to an overseas entity, some companies may take the position that the services are not related to goods in China, while the tax authorities believe the services are for the purpose of facilitating the import of certain goods into China and, therefore, are related to goods in China and do not qualify for a VAT exemption. We expect uncertainties in obtaining VAT exemption status due to different interpretations of these rules. Even if such companies complete the VAT exemption registration procedure, there are potential risks for challenges by the tax authorities during tax audits.

Bulletin 29 is silent on certain VAT reporting issues, such as whether the taxpayer must file in the export VAT refund system if it relinquished zero-rated treatment. Affected enterprises will need to be aware of and monitor local implementation and administration of the rules.

Appendix: Cross-border taxable activities eligible for VAT exemption

(* Newly added exempt items since 1 May 2016)

Category	No.	Cross-border taxable activities	Clarifications on implementation
A – Cross-border activities that take place outside China	1	Construction services provided on projects outside China*	Including construction services provided by a general contractor and a subcontractor on projects where the construction sites are outside China
	2	Project supervision and management services provided on projects outside China*	
	3	Engineering survey and exploration services provided on projects outside China or mineral resources outside China	
	4	Conference and exhibition services provided for conferences and exhibitions outside China	Including organization and arrangement services provided for clients to attend conferences or exhibitions outside China
	5	Storage services where the warehouse is outside China	
	6	Leasing services of moveable property where the leased property is used outside China	
	7	Broadcasting services of radio, TV and film programs (work) outside	Including the broadcasting of radio, film and TV programs (work) in overseas movie or video theatres, theatres and other venues

		China	Excluding the broadcasting of radio, film and TV programs (work) outside China through wired or wireless devices in China, including radio, TV, satellite communications, internet, cable TV, etc.
	8	Cultural and sports services, education and medical services and tourism services provided outside China*	<p>Including cultural and sports services, education and medical services provided onsite outside China and organization and arrangement services provided for clients to attend science and technology activities, cultural activities, cultural performances, cultural competitions, sports competitions, sports performances and sports activities outside China</p> <p>Excluding cultural and sports services, education and medical services provided to overseas entities and individuals through radio, TV stations, satellite communications, internet and cable TV in China</p>
B – Services provided for exported goods	9-1	Postal services for exported goods	Including postal delivery of letters and packages, the publishing of postal stamps and export stamp albums to overseas
	9-2	Collection and delivery services for exported goods	Collection, classification and delivery services provided for letters and packages with overseas destinations
	9-3	Insurance services for exported goods*	Including export goods insurance and export credit insurance
C – Services sold to overseas entities and wholly consumed outside China	10	Telecommunication services provided to overseas entities and wholly consumed outside China	Including telecommunication services provided to overseas entities and individuals where the fees are settled through overseas telecommunications service providers
	11	Intellectual property services provided to overseas entities and wholly consumed outside China	Excluding situations where the service recipient is a Chinese entity or an individual
	12	Logistics auxiliary services provided to overseas entities and wholly consumed outside China (except for warehousing services and collection and delivery services)	Including aviation on-land services, port and wharf services, goods and passenger transportation station services, salvage and rescue services, loading, unloading and moving services provided by taxpayers to overseas service providers engaged in international transportation and transportation between Hong Kong, Macau, Taiwan and the Mainland when they pass and park in Chinese airports, wharfs, stations, Chinese territorial space, inland rivers and territorial seas
	13	Assurance and consulting services provided to overseas entities and wholly consumed outside China	<p>Excluding the following situations:</p> <ul style="list-style-type: none"> • Where the actual service recipient is a Chinese entity or an individual; • Certification services, assurance services and consulting services provided on

			goods and real property in China
14	Professional technical services provided to overseas entities and wholly consumed outside China*		<p>Excluding the following situations:</p> <ul style="list-style-type: none"> • The actual service recipient is a Chinese entity or an individual; • Meteorology services, earthquake services, ocean services, environment and ecology monitoring services provided with respect to weather, earthquakes, oceans, the environment and ecology in China; • Survey and map drawing services regarding land features, geological structures, hydrological and mineral resources situations in China; • Construction planning services for cities and townships in China
15	Business support services provided to overseas entities and wholly consumed outside China*		<p>Including the following situations:</p> <ul style="list-style-type: none"> • Customs declaration agent services and foreign forwarding services provided to overseas entities; • Mariner outsourcing services provided to overseas entities; • Human resources services provided to overseas entities in the form of outbound labor cooperation arrangements that take place outside China <p>Excluding the following situations:</p> <ul style="list-style-type: none"> • The actual service recipient is a Chinese entity or an individual; • Investment and asset management services, property management services and real estate agency services provided in relation to real property in China; • Agency services provided in an auction of good or real property in China; • Legal agency services provided in relation to disputes regarding goods or real property in China; • Security protection services provided for goods or real property in China
16	Advertising services sold to overseas entities for advertisements to be distributed outside China		Advertising services for advertisements to be distributed outside China
17	Intangible property sold to overseas entities and wholly consumed outside China (excluding technology)*		<p>Excluding the following situations:</p> <ul style="list-style-type: none"> • The intangible property is not used entirely outside China; • The natural resources use right transferred is related to natural resources in China; • The infrastructure operation right or

			<p>public utilities license transferred is related to goods or real property in China;</p> <ul style="list-style-type: none"> • Transfer of quotas, operating rights, distribution rights and agent rights to overseas entities for the sale of goods, services, intangible or real property in China
D – Specified financial services	18	Financial services provided for financing or other financial business between overseas entities where the services are not related to goods, intangible assets or real property in China*	Financial services provided for financing or other financial business between overseas entities, including fund clearance, fund settlement, financial payment and account management services provided for foreign currency or RMB fund transfers between overseas entities or between overseas entities and individuals
E – Specified international transportation services	19	Specified international transportation services	<p>Including the following situations:</p> <ul style="list-style-type: none"> • Providing international transportation services as a carrier without transportation vehicles;* • Providing international transportation services without obtaining the relevant operating license or where the approved business scope does not include such services
F – Cross-border taxable activities eligible for zero-rating, but the taxpayer has opted for simplified taxation or relinquished zero-rated treatment	20	Cross-border taxable activities eligible for zero-rated treatment, but the taxpayer has opted for the simplified taxation method or has elected to relinquish zero-rated treatment	<p>Including the following cross-border taxable activities eligible for zero-rated treatment, but where the taxpayer has opted for the simplified taxation method or relinquished zero-rated treatment:</p> <ul style="list-style-type: none"> • International transportation services; • Space transportation services; • The following services provided to overseas entities and wholly consumed outside China: <ul style="list-style-type: none"> ○ R&D services; ○ Contract energy management services; ○ Design services; ○ Production and publishing services of radio, movie and TV program (work); ○ Software services; ○ Circuit design and testing services; ○ Information system services; ○ Business process management services; ○ Offshore service outsourcing services; • Technology transferred to overseas entities and wholly consumed outside China

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