

VAT reform in Shanghai

(Circulars 110 & 111)



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Further to the announcement of the PRC indirect tax reform, the Ministry of Finance and the State Administration of Taxation jointly issued two circulars, Caishui [2011] 110 (“Circular 110”) and Caishui [2011] 111 (“Circular 111”), on 16 November 2011 to provide the implementation details of the pilot program of indirect tax reform in Shanghai which is effective from 1 January 2012.

In general, Circular 110 provides the basic principles and mechanisms for the transformation of business tax (“BT”) to VAT under this pilot program. Circular 111 includes 3 appendices which provide the relevant implementation details.

Salient points of the Circulars include:

Types of VAT payers

There are two types of VAT payers: general VAT payers and small scale VAT payers.

- **General VAT payers**

Threshold for general VAT payers under this pilot scheme is annual sales of at least RMB 5 million. However, road and water transport service providers that have already issued invoices on their own but with annual sales value of less than RMB 5 million should also apply for general VAT payers. For general VAT payers who render public transport services, they may choose to adopt simplified method to compute their VAT payable.

- **Small scale VAT payers**

Small scale VAT payers who possess proper accounting systems and can ascertain and provide relevant tax information may also apply for general VAT payer status.



Applicable tax rates

- On top of the existing VAT tax rates of 17% and 13%, there will be two additional tax rates of 11% and 6% for general VAT payers.
- VAT levy rate (applicable to small scale VAT payers) remains at 3%.

Each new VAT-able service would be subject to different applicable rates or a levy rate (as the case may be) which are set out as follows:

	Applicable VAT rates	Applicable BT rates before the reform
Transportation Services		
Road transport (excluding railway transport)	11%	3%
Water transport	11%	3%
Air transport	11%	3%
Pipeline transport	11%	3%
Applicable Modern Services		
R&D and technology	6%	5%
Information technology	6%	5%
Cultural and innovative	6%	5%
Logistics auxiliary	6%	5%
Tangible moveable property leasing	17%	5%
Certification and consulting	6%	5%

VAT basis

In principle, total income should be the basis for computing VAT. However, for the industries where large amount of disbursements are made on customers' behalf, taxable income can be after deducting reasonable amounts of those disbursements. In fact, some industries such as international freight forwarders, which are allowed to deduct BT computed on net margin basis, can deduct payments made to non-pilot enterprises (both in Shanghai and outside Shanghai) in arriving at taxable turnover for VAT purpose.

VAT computation methods

Two computation methods:

General method

The formula of general method (which is applied to general VAT payers) is

VAT payable = Output VAT – Input VAT

Simplified method

For small scale VAT payers, the formula of simplified method is:

VAT payable = Sales (excluding VAT) x levy rate

No input VAT can be claimed under this formula.



What should enterprises do?

The reform shall bring drastic changes in internal control and accounting systems. Enterprises under the pilot scheme should study the relevant implications of the reform in order to be in line with the VAT reform requirements. For example, it is required that enterprises should separately record VAT-able and BT-able income as well as listing out each VAT-able line of business with different VAT rate or levy rate. Changes in internal systems may be needed in order to record/prepare the new information.

Although the VAT reform is globally in line with the prevailing VAT practices applicable to sales of goods, the enterprises who were purely BT payers before the reform may not be familiar with those practices, especially in the administration areas such as application for general VAT payer, management of VAT invoices, VAT computations and VAT filings. **Proper training should be provided to the appropriate staff.**

The reform may be beneficial to some parties but not all enterprises. Enterprises should study possible implications for themselves, their customers and service providers. In fact, customers who are BT payers may have to suffer tax wise if their service providers have to be changed from BT payers to VAT payers under this pilot scheme.

Likewise, **the reform only provides options of zero rate (with VAT refund) and VAT exemption (with no VAT refund) for the export of services.** However, no further details are provided. If VAT is not refunded, it would certainly weaken the competitiveness on international markets. On the other hand, customers who are currently VAT payers may benefit from VAT credit claim. As such, a review on service chain is required and may result on the re-negotiation of relevant prices.

Although the issue of these two Circulars may clarify certain points in the implementation, there are still a lot of issues to be discussed. We expect the relevant authorities to issue more circulars in order to clarify those outstanding points.

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