

Understand the VAT System in China: Scope, Taxpayer Types, VAT Rates and Invoice

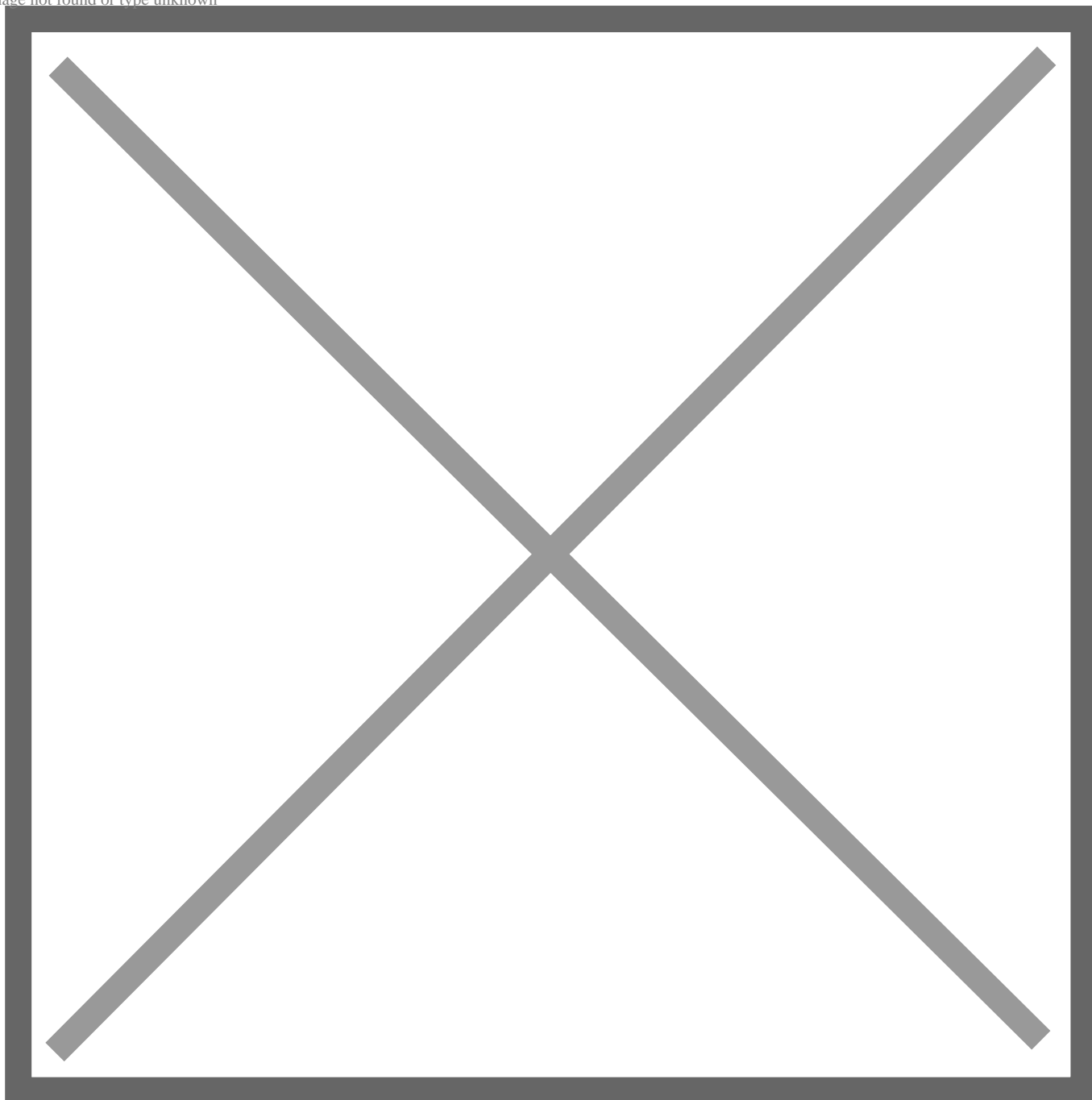
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Before 1 May 2016 China's turnover tax system was comprised of value added tax ("VAT"), business tax ("BT") and consumption tax ("CT"). Starting in 2012, China rolled out a nationwide reform to unify the BT into the VAT system, making VAT the dominant tax revenue source.

From 1 May 2016 on, the reform began to cover all industries nationwide and BT no longer exists in the tax system in China. CT is levied on specified non-essential or luxury consumer commodities. The CT revenue is significantly less than VAT revenues.

However, from a company point of view, both VAT and CT as turnover taxes are important since they have a significant influence on the market price of company products and services provided.

As the dominant and most important tax category in the turnover tax system, the VAT system in China is not just a pass-through tax: it involves a complicated process based on a credit system, closely connected with monitoring of special VAT invoices ("fapiao"). In different business establishments, the credit system varies. It is crucial that small- and medium-sized companies understand how the system works and make the best use of it, not simply in terms of saving tax costs but also avoiding compliance risks.

The EU SME Centre's guideline [Understanding China's Turnover Tax System](#) outlines the basic logic of the taxation system and provides an overview and understanding of China's turnover tax system, with highlights on special areas or topics for small businesses.

Scope of VAT in China

In general, China's VAT applies to the following taxable activities within the territory of the People's Republic of China ("China") with considerations by companies or individuals:

- Sale of goods;
- Importation of goods;
- Sale of processing, repair and replacement services;
- Sale of transportation services, postal and telecommunication services, construction services, financial services, modern services and lifestyle services (collectively, "the Taxable Services");
- Sale of intangible assets;
- Sale of real estate.

For a complete list of taxable items and tax rates, please find them in the [guideline here](#).

VAT Taxpayer

According to the VAT provisional regulation, any unit or individual selling goods; providing processing, repair and replacement services; or importing goods within China is subject to VAT. The pilot reform sets out more service categories that are VAT taxable, stating that any unit or individual providing Taxable Services within China is also subject to VAT.

In the VAT implementation rules, "unit" refers to enterprises, administrative institutions, business units, military units, social organisations and other organisations. "Individuals" include both individually owned enterprises and natural persons which are also called "other individuals" VAT taxpayers can be divided into two kinds: small-scale taxpayers and general taxpayers.

Small-scale VAT Taxpayer

Small-scale VAT taxpayer refers to a taxpayer who is unable to keep accounting books according to the standard accounting rules of the state, cannot provide accurate tax materials according to the legitimate and valid proof documents. Small-scale taxpayers with annual taxable sales exceeding the relevant annual sales threshold mentioned below in the previous 12 successive months must register for general taxpayer status. The thresholds are:

- **CNY 500,000** (around EUR 70,000 when this report is drafted. Same below.) if engaged solely or mainly in the production of goods or provision of processing, repair and replacement services; or
- **CNY 800,000** (around EUR 100,000) if engaged in wholesale or retail of goods; or
- **CNY 5,000,000** (around EUR 700,000) for supplies of the Taxable Services.

General VAT Taxpayer

Taxpayers with annual VAT taxable sales above the threshold of small-scale VAT taxpayer must register as a general VAT taxpayer. Newly established enterprises and other enterprises whose annual taxable sales are no more than the thresholds may voluntarily apply for the general taxpayer status. A general VAT taxpayer enjoys input VAT credit for the purchase of goods or services.

VAT Rates

There are two kinds of VAT rates: tax rates and levy rates. For small-scale taxpayers, the VAT levy rate of 3% is applicable. For the general taxpayer, VAT tax rates may vary from 17%, 13%, 11%, 6% or even 0%, depending on the nature of the goods or services involved. The VAT levy rate for general taxpayers is 3% or 5%.

To find out the VAT rates in different sectors in China and the calculation formula, see the [guide](#).

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China VAT Invoice System

In China, all business transactions are required by law to be recorded on an official receipt (or 'fapiao' in Chinese). Contrary to other countries, fapiaos are more than just ordinary receipts. Fapiaos are distributed, and administrated by tax authorities, and taxpayers are required to purchase the fapiaos they need from the tax authorities according to their business scope. Fapiaos are physical paper invoices printed with a special printer by specially trained and qualified employees of companies that have achieved "general taxpayer" status.

When an enterprise is incorporated, it needs to state what activities it intends to perform on its business Licence, and keep its actual operations within this scope. The fapiao system is one means to enforce this requirement, as the enterprise cannot issue fapiao for activities outside its business scope.

VAT Fapiao can also be sorted into two categories:

- **Special VAT fapiao** – the most commonly input VAT vouchers for input VAT deduction, issued by a general VAT taxpayer to another business;
- **General VAT fapiao** for all other instances, including sales to small-scale taxpayers and consumers, VAT-covered transactions done by small-scale taxpayers (more below), or sales of tax-free goods and services.

Looking for more information? Find them in our guideline [Understanding China's Turnover Tax System](#).