7.2. VAT, Surcharges and other taxes(RC)

Introduction

China has transitioned from a business tax towards Value-added Tax. Other taxes still do exist though.

Consumption Tax and Business Tax

Consumption Tax and Business tax are only relevant in certain cases, e.g. if your business is in the areas of alcohol, gasoline, petrol and jewelry and should be filed monthly.

VAT and Import VAT

Resident companies which generate revenues have to be registered as tax payer or – under certain conditions – as a small-scale tax payer.

Mostly prices in China are declared as prices including VAT. To better understand the nature of VAT it helps to keep in mind that this money never really belongs to the company itself: It is just collected for the tax authorities and therefore treated as "Payables" for outgoing VAT or "Receivables" for Incoming VAT. Due to this circumstance, most business tend to make their business plans on Net payments, excluding VAT.

The value-added tax for incoming VAT is only deductible if you can provide a special VAT invoice. This should be mostly the case for all expenses that are related to generating income for the company. For every other expense, the VAT will be non-deductible which will result in a higher tax-load for the company: This definitely is something to keep in mind when you are planning investments, e.g. in fixed assets and construction.

The following example shows that:

- Calculation excluding VAT ("Net") and including VAT ("Gross") does not have any influence on the Earnings before Tax. See columns 1 and 2.
- Receiving a normal Fapiao vs. a special VAT Fapiao and/or buying services or products which are non-deductible for VAT will have a negative influence on the Earnings before Tax.

	(1) Net	(2) VAT Deductible	(3) Non-VAT Deductible
Turnover	200	232	232
Cost of Goods	-100	-116	-116
VAT Payables*	0	-16	-32
EBT	**100**	**100**	**84**

***VAT Payables calculation:**

VAT In	0	16	0
VAT Out	0	-32	-32

Figure 10: VAT Scenarios

For exports, the VAT rate in general is 0% and companies can ask for a return of the VAT for the used raw materials in general.
The VAT tax returns can be filed until the 15th of the following month.

Import VAT has to be settled within 15 days after the issuance of the tax payment certificate.

VAT: Deemed Sales

If a company decides to give out goods for free they can be considered as "deemed sales" and VAT has to paid by the company under certain circumstances, e.g.:

- Giving marketing goods for free to cooperation partners
- Giving goods to employees as benefit.

The VAT for these cases is calculated based on the selling price multiplied with the applicable VAT Rate, e.g.:

- Product Cost: 500 RMB
- "Usual" sales price: 1000 RMB
- VAT for "deemed sales": 1000 RMB * 16 % = 160 RMB.

Quantity discounts, e.g. "buy one get one free" are treated in the same way as cash discounts: While the first item will be fully taxed in the usual way, the second item will be taxed in the same way as the first item, even if there is no generated turnover.
Therefore, a price discount is the more efficient way regarding taxation.

See also the following examples:

We assume a company sells two items which it buys each for 58 RMB and sells it for 232 RMB including VAT, leading to total payable VAT of 48 RMB.

	Item 1	Item 2	Total
Turnover	232	232	464
Cost of Goods	-58	-58	-116
VAT Payables*	-24	-24	-48
EBT	**150**	**150**	**300**

*VAT Payables calculation:			
VAT In	8	8	16
VAT Out	-32	-32	-64

Figure 11: Example "VAT for normal sales"

If the company then gives a Discount of 50%, the calculation changes as follows, leading to payable VAT of 32 RMB:

	Item 1	Item 2	Total
Turnover	116	116	232
Cost of Goods	-58	-58	-116
VAT Payables*	-8	-8	-16
EBT	**50**	**50**	**100**

*VAT Payables calculation:			
VAT In	8	8	16
VAT Out	-16	-16	-32

Figure 12: Example "VAT for discounted sales"

The last example shows that the total turnover and the total Cost of Goods do not change if the company decides to give a discount by providing “Buy one get one free” which effectively is a discount of 50% either. Since the VAT still has to be paid for the goods that are given out for free, the tax load of the company is increased.

	Item 1	Item 2	Total
Turnover	232	0	232
Cost of Goods	-58	-58	-116
VAT Payables*	-24	-24	-48
EBT	**150**	**-82**	**68**

*VAT Payables calculation:			
VAT In	8	8	16
VAT Out	-32	-32	-64

Figure 13: Example "VAT for buy-one-get-one-free"

Surcharges

As mentioned before, companies often create their internal reporting and budgeting systems on a “net”-Basis and VAT will never show directly up in the profit and loss calculation since it is directly considered as Payables or Receivables for the tax authorities.

Added to VAT there are some surcharges which are calculated on the VAT as basis. They might vary for each region, but the surcharges could be:

- Education Tax: e.g. 3% of VAT
- Local Education tax: Depends on the region, e.g. 2%
- Urban Construction and Maintenance tax: e.g. 1-7% depending on the area.

These taxes can be shown in the Profit & Loss calculation under “Other taxes”.

Stamp tax

Depending on the document type, certain stamp taxes have to be paid. Relevant documents e.g. are:

- Contracts or documents with the nature of a contract
- Documents regarding the transfer of property rights
- Business account books
- Certificates evidencing rights or licenses
- Other documents that are determined by the Ministry of finance.

Exempted from tax are

- Duplicates or copies
- Documents regarding donations of property to the government, social welfare institutions or schooks
- Other documents which are exempted as defined by the ministry of finance.

The tax is either calculated based on the value in the underlying document or based on the amount of documents that were stamped, depending on the nature of the document. Mostly, both parties stamping the document have to pay the relevant tax.
Some examples with relevant tax rates from July 2018:

- Sales and Purchasing contracts: 0.03% of the value of the purchases

- Contracts for survey and design during construction: 0.05% of the receipts
- Certificates and Licenses: 5 RMB each.

Since stamp tax has to be paid in RMB, transactions in foreign currency have to be converted to Renminbi by using the official rate of the PBOC´s exchange rate of the day to calculate the correct tax.

Real Estate Tax and land using rights

Transactions regarding real estate also require the payment of taxes, e.g.:

- Buying real estate or land using rights: 1.2 % of the remaining real estate value
- Property Tax: 1.2% of the remaining real estate value if used by yourself or 12% of the rental income for properties that are rented out.
- Deed Tax: For acquiring land from the state, transfer or land using rights and the purchase and sales of real property a deed tax of 3-6%, depending on the region, is levied.
- Renting real estate:
    - 12% of the real rental value for businesses
    - 4-7% depending on the compound of the rental value.

The tax will in general be paid by the person using the property, not the seller or landlord.

Land appreciation tax

When selling land using rights, the appreciation of value will be taxed based on brackets and considers the acquisition cost of the land using rights and the building cost. For each bracket, between 30% to 60% of tax are required:

Appreciated value in % of the deductible cost	**Tax rate**
Below 50%	30%
50-100%	40%
100-200%	50%
Above 200%	60%

Figure 14: Land appreciation Tax Table

To make an example: Property and Building cost are 6 RMB and they get sold for 20 RMB, the tax will be like this:
Total appreciation is

20 RMB – 6 RMB = 14 RMB.

The taxes in each bracket are:

- 6 RMB * 50% = 3 RMB.
  With the tax rate of 30%, the tax will be *3 RMB * 30% = 0,9 RMB in this bracket.*
- 6 RMB * 100% = 6 RMB.
  With the tax rate of 40% the tax will be *(6 RMB – 3 RMB) * 40% = 1.2 RMB in this bracket.*
- 6 RMB * 200% = 12 RMB.
  With the tax rate of 50% the tax will be *(12-6) RMB * 50% = 3 RMB in this bracket.*
- 14 RMB – 12 RMB = 2 RMB.
  With the tax rate of 60% the tax will be *2 RMB * 0,6 = 1,2 RMB in this bracket.*

This results in total taxes of:

0,9 + 1,2 + 3 + 1,2 = 6,3 RMB.

Or to sum it up in a table:

			In each bracket:		
	% of Purchasing cost define the tax brackets	**Taxed Appreciation (cumulated)**	**Taxable Amount**	**Tax Rate**	**Tax**
1.	50% * 6 RMB =	3,0	3,0	**30%**	0,9
2.	100% * 6 RMB =	6,0	3,0	**40%**	1,2
3.	200% * 6 RMB =	12,0	6,0	**50%**	3,0
4.	More than 200%	14,0	2,0	**60%**	1,2
Total		**14,0**	**14,0**	45%	**6,3**

Figure 15: Land Appreciation Tax Example

As you can see, the land appreciation tax can have a steep impact on the consideration if selling real estate that belongs to the company is really worth it.

Considerations:

- Measurement of the stamp tax?