

# Tax Analysis

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## PRC Tax Indirect Tax Services

### SAT makes changes to rules governing recognition and administration of general VAT taxpayers

The State Administration of Taxation ("SAT") recently issued new *Administrative Measures on the Recognition of General Value-Added Tax (VAT) Taxpayers* ("Recognition Measures"), as well as two notices to supplement the Recognition Measures (*Notice Clarifying Certain Articles of the Recognition Measures* (Guoshuihan [2010] No. 139) and *Notice on the Issuance of the Administrative Measures of General VAT Taxpayers in Supervisory Period* (Guoshuifa [2010] No. 40)). These rules were issued pursuant to the *Provisional Regulations on VAT* and their Implementation Rules as amended at the end of 2008. The Recognition Measures and the supplementary notices are effective as from 20 March 2010.

#### Main changes

- Lowering the annual sales threshold for general VAT taxpayer recognition purposes

A taxpayer whose annual sales reach a threshold must apply for recognition of general VAT taxpayer status, with the applicable threshold depending on the taxpayer's business. The amended VAT Regulations significantly lowers the threshold:

§ For taxpayers wholly or mainly engaged in manufacturing or the provision of VAT taxable services, the threshold is reduced from RMB 1 million to RMB 0.5 million;

§ For other taxpayers, the threshold is reduced from RMB 1.8 million to RMB 0.8 million.

- Clarification of "annual sales"

The Recognition Measures and relevant notices specify that the term "annual sales" includes:

§ Sales reported in the tax return;

§ VAT exempt sales;

§ Sales recorded in VAT invoices issued by the tax authorities on behalf of the taxpayer; and

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- § Under-reported sales verified by the tax authorities through a tax audit or an assessment.

It is further clarified that under-reported sales verified by the tax authorities should be included in the sales of the month in which the under-reported sales are verified rather than the month the sales took place.

Under the previous rules, annual sales meant the total VAT-taxable sales amount within a calendar year. Thus, a taxpayer whose annual sales exceeded the threshold within a calendar year had to apply for general VAT taxpayer recognition before the end of January in the following year. The Recognition Measures redefine annual sales as the accumulated sales of a continuous 12-month period of operations. The "operations period" is the period in which the taxpayer conducts business operations, and the 12-month period is counted on a continuous basis even if the taxpayer has no sales in a particular month. Therefore, a taxpayer must apply for recognition as a general VAT taxpayer within 40 working days after the end of the VAT filing period of the month (quarter) in which the annual sales threshold is exceeded.

- Recognition of general VAT taxpayer status for newly established companies

According to the old regulations, a newly established company (except a trading company) was able to apply for general VAT taxpayer status on a tentative basis if its annual sales were estimated to exceed the threshold, with a formal application made at the time the threshold was actually exceeded. There were two categories for newly established trading companies:

- § Small-scale trading companies had to meet the annual sales test (i.e. RMB 1.8 million); otherwise, general VAT taxpayer status could not be granted; and
- § Other trading companies (including retailers with fixed premises of operation and physical merchandise, large- and medium-scale trading companies with registered capital exceeding RMB 5 million and having more than 50 employees, and other large- and medium-scale trading companies with fixed premises of operation, a stable supplier/customer base and a sound management/accounting system) could apply for general VAT taxpayer status upon tax registration.

Under the Recognition Measures, newly established companies, including newly established small-scale trading companies (regardless of whether estimated sales will exceed the threshold), can apply for general VAT taxpayer status within 30 days after tax registration, provided the company has fixed premises of operations and a sound accounting system.

- Simplification of recognition procedures

Under the old regulations, after a preliminary review of the application package, the tax authorities required the applicant to complete the General VAT Taxpayer Status Recognition Form, with recognition status granted after a second review and within 30 days after the Form was submitted. The Recognition Measures require the tax authorities to complete the recognition procedure within 20 working days after acceptance of the application.

- Supervisory period

The old regulations provided for an at least six-month supervisory period for trading companies that were newly recognized as general VAT taxpayers (except for large- and medium-scale trading companies with fixed premises of operation, stable supplier/customer base and sound management/accounting system) during which the use of VAT invoices and credit of VAT input were under the strict control of the tax authorities. The Recognition Measures reduce the supervisory period to three months for small-scale wholesalers (i.e. wholesalers with registered capital of no more than RMB 0.8 million and no more than 10 employees) that are newly recognized as general VAT taxpayers but whose annual sales have not reached the threshold yet.

The Recognition Measures and supplementary notices also allow a six-month supervisory period for general VAT taxpayers that have tax violations (e.g. where a taxpayer evades VAT and the amount exceeds RMB 100,000 and accounts for more than 10% of total tax payable, tax fraud in an export refund application or the issuance of VAT invoices, etc.).

Under the previous rules, small-scale wholesalers, in principle, could not issue VAT invoices in an amount exceeding RMB 10,000 during the supervisory period. The Recognition Measures increase the ceiling to RMB 100,000 for small-scale wholesalers, and for other general VAT taxpayers, the ceiling can be assessed based on the actual situation.

- Starting point of general VAT taxpayer status

The Recognition Measures clearly state that a taxpayer can enjoy general VAT taxpayer treatment as from the month after the recognition and newly established companies can enjoy general VAT taxpayer treatment as from the month of recognition. The old regulations did not specify the start date of general VAT taxpayer status.

#### Comments

The Recognition Measures, to a large extent, reduce the threshold for annual sales of a general VAT taxpayer so that more taxpayers will have general VAT taxpayer status. At the same time, the Recognition Measures simplify the procedures in favour of recognition.

The Recognition Measures allow taxpayers to apply for general VAT taxpayer status provided they have fixed premises of business operations and sound accounting systems, even though they do not meet the annual sales test. Therefore, taxpayers whose annual sales are lower than the threshold should assess the potential tax benefit from general VAT taxpayer status, under which a 17% VAT rate generally applies and input VAT is creditable, before deciding to remain as small-scale VAT taxpayers. A 3% VAT rate is applicable for small-scale VAT taxpayers, but input VAT cannot be recovered. However, if annual sales have exceeded the threshold, the taxpayer must apply for general VAT taxpayer status; otherwise, the taxpayer can be penalized by paying output VAT at the standard rate of 17% without credit for any input VAT and the taxpayer will not be allowed to issue VAT invoices.

For more information, please contact our Indirect Tax professional team.