

After the VAT Reform, General VAT Payers can Claim Input VAT Credit against Output VAT on Purchased Equipment

By David Yu and Clare Lu

Since 1999, foreign-invested Research and Development (R&D) centres could enjoy exemptions on Customs Duty (CD) and Value Added Tax (VAT) on imported self-use equipment and relevant supporting technologies, accessories and parts. This was provided that such goods could not be manufactured domestically. However, under the PRC's VAT reform, the above preferential import VAT treatment was terminated on 1 January 2009.

As such, when analysing the VAT reform impact on taxpayers, much attention has been paid to the increased equipment purchase costs borne by R&D centres. To solve this problem, on 10 October 2009 the Ministry of Finance, the General Administration of Customs and the State Administration of Taxation, issued the *Circular on Taxation Policies on Purchasing of Equipment by R&D Organisations* (Cai Shui [2009] No. 115, 'Circular No. 115'). Circular No. 115 stipulates that foreign-invested R&D centres are eligible for tax exemption on equipment and relevant articles that are imported for science/technology research and development purposes, and that R&D organisations (domestic-invested and foreign-invested) can enjoy a full VAT refund upon purchasing domestically made equipment.

Preferential Tax Treatment

The scope of taxes refunded and exemption policies previously granted to domestically-invested enterprises was smaller than that granted to foreign-invested enterprises, resulting in discrimination against the former. In light of this, these tax refunds and exemption policies were cancelled in the VAT reform – although the CD exemption on equipment imported by foreign-invested R&D centres (including internal R&D departments of foreign-invested enterprises) remained unchanged.

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After the VAT reform, general VAT payers can claim input VAT credit against output VAT on purchased equipment, thereby avoiding double preferential tax treatment. In practice, with the exception of a few that are granted VAT general taxpayer status, most foreign-invested R&D centres are Business Tax payers. Under the prevailing VAT regime, Business Tax payers are not qualified to claim input VAT credit. As a result, the input VAT paid and borne has led to salient increases in equipment acquisition costs.

New Policies under Circular No. 115

Foreign-invested R&D centres are one of the major vehicles for the PRC to introduce overseas advanced technologies for the purpose of improving domestic technical and R&D capabilities. The relevant government authorities issued Circular No. 115 to enhance the utilisation of foreign investment and to perfect industrial and foreign investment structures in the PRC. The Circular states that foreign-invested R&D centres that meet certain criteria are granted VAT exemption when importing equipment and relevant articles for science/ technology R&D purposes.

The Circular further stipulates that three types of organisations can enjoy a full VAT refund when purchasing domestically made equipment. These include:

- foreign-invested R&D centres that meet the above mentioned criteria,
- scientific research and technological development organisations as specified in the *Tentative Provision on Exemption of Import Taxes upon Equipment Importation for Science and Technology Research and Development Purposes* (Order No. 44), and
- scientific research organisations and schools as specified in the *Provision on Exemption of Import Taxes upon Equipment Importation for Scientific Research and Teaching Purpose* (Order No. 45).

However, we feel that the following items cannot be ignored when applying for VAT preferential treatment:

- Circular No. 115 delineates the equipment categories that qualify for preferential VAT treatment. These include imported equipment and relevant articles for science and technology development purposes, as well as necessary experimental facilities, equipment and machines. These are listed in the appendix (List of Equipments for Science and Technology Development, Research and Teaching Purposes) of the Circular and are different from those provided prior to VAT reform.
- The Circular stipulates certain criteria on qualified foreign-invested R&D organisations that are eligible for tax exemptions/ refunds on the purchasing of equipment. These are stricter than prior to VAT reform.
- The Circular was issued on 10 October 2009, with the effective period from 1 July 2009 to 31 December 2010. However, the Circular is unclear as to the determination method of the effective date, i.e. the

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execution date and the import declaration date of the agreement, and the date of issuance of the invoice. And it is unclear as to the application process of such preferential treatment, i.e. when to apply, to whom, and what kind of documents are required. In particular, it does not mention how preferential tax treatment can be retrospectively applied to equipment purchased before 1 July 2009. Additionally, the Circular does not state the method for defining the termination date of 31 December 2010.

Given the ambiguity surrounding the above issues, the Circular will add to the uncertainty for equipment purchasers applying for preferential tax policies. It is therefore suggested that equipment purchasers comprehensively and effectively communicate with the relevant business, customs and taxation government authorities in order to avoid potential risks in the future.

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