

VAT Tips - PRC VAT rules on claiming input credits

Buyer in good faith

It is understood that by having a bigger amount of input VAT, the taxpayer can get a smaller amount of VAT payable, or alternatively the taxpayer can obtain a larger amount of export refunds. However, the taxpayer should be aware of the dividing line between a lawful claim for input credit (or export rebate) and an unlawful one. It is a legal requirement that (i) the taxpayer should have a genuine underlying transaction for each incoming and outgoing VAT special invoice. A good piece of evidence is the transportation invoice that goes with the purchase transaction; (ii) the information of the quantity, value, and the amount in the VAT special invoice should match with the particulars of the actual transaction; (iii) the VAT special invoice the buyer receives has been purchased from the tax bureau at the city (or the district in a large city) where the seller is located, and that (iv) there is no evidence suggesting that the buyer knows that the seller has obtained the VAT special invoice in any lawful way. The tax authority can pardon the taxpayer if the VAT special invoice turns out to be a fake or to have been obtained in an unlawful way. The tax authority will only revoke the input credit already claimed and shall not impose any administrative penalty on the buyer. The taxpayer can get the input credit if it can obtain a valid replacement VAT special invoice from the seller against whom the tax authority has taken administrative action.

Legal responsibility

If there is any evidence showing that the buyer knows that the VAT special invoice has been obtained by the seller in an unlawful way, then the buyer cannot get away. Likewise, in spite of the fact that there has been a genuine transaction, and that there is a VAT special invoice for the actual purchase, the taxpayer shall get punished if input credit or export rebates have been claimed in any of the following ways:

- (i) The purchase invoice is issued by a party other than the seller;
- (ii) The purchase invoice is stamped by a party other than the seller;
- (iii) The description, quantity, and unit price of the goods in the VAT special invoice do not match the particulars of the actual purchases.

If the above is brought to light, the legal consequences will be two folds: the tax

authority shall revoke the input credit or rebates, and the taxpayer shall face fines as well as administrative punishment. The taxpayer is not supposed to have the knowledge that the seller obtains the VAT special invoices in an unlawful way¹. The following self-explanatory evidence shows that the taxpayer not only knows about the unlawful practice but has acted in collusion with the seller in order to benefit from it: (i) the VAT special invoice not matched by the underlying transaction for the sale and purchase of goods; (ii) the acceptance of a third party VAT special invoice; and (iii) the VAT invoice purchased from the tax bureau that is located outside the seller's city. Where the invoice has been used improperly, the taxpayer and the legal representative will either face administrative punishment or in serious case the criminal consequences. The good faith buyer should get to know the judicial interpretation by the People's Supreme Court that sets out the scope of criminal liability for unlawful acts related to VAT special invoices (i) issuing or accepting fictitious VAT special invoices in the absence of a purchase or sale transaction, issuing fictitious VAT special invoice for a third party or accepting the same from a third party in the absence of a buy-sell transaction; (ii) given that there is a purchase or sale transaction, issuing or accepting VAT special invoices that show an incorrect amount for the purchase or sale transaction, or issuing the same for a third or accepting the same from a third party; (iii) with an actual transaction, the taxpayer commissions a third party to issue VAT special invoice on his behalf.² There threshold amount of tax evasion to trigger a criminal liability for acts as mentioned above is five thousand RMB(¥5,000) where the VAT input credit or VAT export refund has been claimed. Where the taxpayer is found evading tax that does not give rise to a criminal responsibility, the administrative authority shall have the power to cancel the unlawful transaction and can impose a fine being no less than 50% but not exceeding 500% of the tax revenue that would not have been lost.³

Ordinary tax invoice

The taxpayer also needs to verify the information in the ordinary invoice from the supplier of goods or services as the invoice can also be used to claim deduction from corporate income tax. Therefore, as a matter of good practice, the buyer should obtain information including the seller's business license, the tax registrations, and the

¹ See Guo Shui Fa 134 (1997) and 182 (2001), issued by the State Administration of Taxation.

² See the interpretation of certain issues relating to the "Decision by the Standing Committee of the National People's Congress on Combatting Crimes Arising from the Issue of Fictitious, Counterfeiting and Unlawful Selling of VAT Special Invoices" given by the Hearing Committee of the People's Supreme Court in the 446th Session.

³ See Article 63 of the PRC Tax Collection and Administration Tax, as promulgated and amended by the National People's Congress.

invoice purchase logbook as issued by the tax bureau in the same city where the seller is located. All these should be done before the buyer is to place a purchase order or to sign contract with the seller.