

# News Flash

## China Tax and Business Advisory

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Our China Indirect Tax Team comprises a team of professionals with rich indirect tax experience and integrated knowledge, both internationally and domestically, stationed in our Beijing, Guangzhou and Shanghai offices. We advise businesses on Chinese indirect tax matters and work on Chinese indirect tax developments. Our Indirect Tax Team in China is part of PwC global indirect tax network of 1,800 experienced and specialized professionals.

## Fine-tuning of Provisional Turnover Tax Regulations

In Issue 13 of our News Flash, we reported that the State Council has released the amended “Provisional Regulations of the People’s Republic of China on Value Added Tax” (“Provisional VAT Regulations”), the amended “Provisional Regulations of the People’s Republic of China on Business Tax” (“Provisional BT Regulations”) and the amended “Provisional Regulations of the People’s Republic of China on Consumption Tax” (“Provisional CT Regulations”) (collectively “Provisional Turnover Tax Regulations”).

We have analysed the three sets of amended Provisional Turnover Tax Regulations and categorized the key changes into three groups: the first group are changes in relation to the VAT Transformation announced by the State Council to date; the second group are changes to improve the assessing practice of each of the Provisional Turnover Tax Regulations; and the third group are changes on tax filing which are applicable to all three sets of Provisional Turnover Tax Regulations. We summarise below the key changes:

### Key Changes in relation to the VAT Transformation

The following major changes are adopted for the amended Provisional VAT Regulations:

- Input VAT incurred on the purchase of fixed assets has been removed from the list of non-creditable input VAT;
- Import VAT exemption for fixed assets imported for contract processing, assembly or compensation trade has been cancelled; and
- The VAT rate for Small-scale taxpayer is reduced to 3%.

### Key Changes to Improve Assessing Practice

The following major changes are adopted for the relevant Regulations:

#### Amended Provisional VAT Regulations

- The amount of input VAT creditable with respect to purchase of agricultural products (with certain exceptions) shall be calculated based on the revised rate at 13% of the purchase price (increased from 10%);
- There is a new provision on deemed input VAT on freight charges paid for the transportation of purchased or sold goods (with certain exceptions). The input VAT is calculated by multiplying the amount of the freight charges by a VAT rate of 7%. This specific input VAT recovery was not addressed in the former

Regulations but appeared in VAT circulars issued by the Ministry of Finance (“MoF”) and State Administration of Taxation (“SAT”). The legal status of this VAT treatment is raised;

- For foreign enterprises or individuals which do not have a business establishment in China but are subject to VAT, there is a new provision stipulating that their business agent or the purchaser of their taxable supplies to be the withholding agent. This specific withholding requirement was not addressed in the former Regulations.

### **Amended Provisional BT Regulations**

- The amended Provisional BT Regulations still allow that, for certain eligible businesses, the BTable turnover can be calculated on a net basis, e.g., a contractor can deduct payments to sub-contractors in calculating its BTable turnover. However, the netting treatment may be disallowed if the prescribed requirements cannot be met. In addition, on-lending business has been removed from the list of eligible businesses;
- Insurance products provided by insurance companies in China for the purpose of insuring export goods are added to list of BT exempt items. This exemption was already announced in a BT circular issued in 2002. This amendment is simply to upgrade that into the amended Provisional BT Regulations;
- Under the former Provisional BT Regulations, a BT taxpayer providing taxable labour services has to file the BT return at the location of where the services are rendered. This has changed under the amended Provisional BT Regulations, i.e., the BT taxpayer providing taxable labour services will have to file BT return at the location of where the taxpayer is located or lives, except for construction business and other taxable services prescribed by the MoF and SAT;
- Similar to the amended Provisional VAT Regulations, for foreign enterprises or individuals which do not have a business establishment in China but are subject to BT, there is a new provision stipulating that their business agent or the purchaser of their taxable services, intangible properties or immovable properties to be their withholding agent; and
- The detailed scope of each of the BT industries listed in the appendix to the amended Provisional BT Regulations has been removed to add more flexibility to the Chinese authorities to update it from time to time as necessary.

### **Amended Provisional CT Regulations**

- There is a new provision which sets out the compound CT rate computation method; and
- The list of items subject to CT and the applicable CT rates is revised.

### **Key Changes in Tax Filing**

- A new quarterly filing period is introduced under all the three sets of the amended Provisional Turnover Tax Regulations. Under the former Regulations, the longest payment period was one month.
- Under all the three sets of the amended Provisional Turnover Tax Regulations, taxpayers, either under the monthly or quarterly VAT, BT and CT filing period, should make their respective tax return filing and payment within 15 days after the end of each filing period. It used to be 10 days for those monthly filers under the former Regulations.
- The VAT and CT payment due date for imported goods is extended from 7 days to 15 days after the issuance of the payment notice by the customs authority.

### **PwC Observations**

- The removal of input VAT incurred on the purchase of fixed assets (defined in Article 19 of the present detailed VAT implementation rules) from the list of non-creditable input VAT would imply that input VAT on fixed assets which used to be specifically disallowed would be creditable as per the amended Provisional VAT Regulations. The same exceptions are still applied to those fixed assets that are used for projects not subject to VAT or exempt from VAT, e.g., collective welfare or personal consumption. In other words, it may not be necessary to define the scope of

“equipment” eligible for “Consumption-base VAT”. However, it is still important for the MOF / SAT to clarify this position.

- We notice that a few of the amendments are just for the purposes of tidying up the regulations, e.g., upgrading some previously policies announced in former tax circulars into the Provisional Regulations.
- The removal of on-lending business from the list of items eligible for calculating BTable turnover on a net basis is going to increase the BT burden of the financial sector. We understand that the Chinese authorities are of the view that the netting treatment was, in practice, only applicable to foreign currency on-lending and not Renminbi on-lending, and hence they just want to eliminate this imbalance.
- The removal of import VAT exemption for fixed assets imported for contract processing, assembly or compensation trade is likely to affect some of the companies which have set up processing factories in the Pearl River delta region, especially the Hong Kong businesses. It would increase their operating costs as the processing factories are exempt from VAT on their processing fees and therefore would not be able to claim input tax credit on the import VAT to be payable on their imported equipment. We hope the relevant Chinese authorities can be aware of this issue and see what can be done to alleviate the financial burden to this group of companies, in particular during the time of financial crisis.

As mentioned above, some of the features of the VAT Transformation are not reflected in the Provisional VAT Regulations. We believe that they will appear in the detailed implementations rules to be announced soon and by way of tax circulars in future. We will closely monitor the development of the detailed implementation rules for the three sets of Provisional Turnover Tax Regulations and share with you our insight as soon as the information is available.

In the context of this News Flash, China or the PRC refers to the People's Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

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