An observation of the key fiscal and taxation task in China’s Government Work Report in 2018

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In brief

On 5 March 2018, the State Council Premier Li Keqiang delivered China’s Government Work Report for 2018 (“the Report”) at the first session of the 13th National People’s Congress (NPC). The Report reviews China’s overall and innovative achievements over the past five years, and sets forth specific recommendations on the work of the Chinese government for 2018.

It is stressed in the Report that China has reduced taxes and levies in the implementation of its fiscal and taxation policies over the past five years, comprehensively implemented the Business Tax (BT) to Value-added Tax (VAT) Transformation Pilot Program (the “VAT Reform”) step by step, and accumulatively reduced taxes by over RMB 2 trillion. Meanwhile, it has also implemented measures such as tax preferential treatment for small and thin-profit enterprises, overhaul of different types of fees, which comprehensively relieves burdens of businesses by over RMB 3 trillion. Besides, China has also made major progress in fiscal and taxation reform by successfully building and developing a system based mainly on sharing of tax revenue between the central and local governments.

Looking into 2018, the Report clarifies China’s fiscal and taxation objectives, including: steadily promoting the legislation of property tax, raising the IIT monthly deduction threshold, further simplifying the VAT rates, and expanding the CIT preferential treatment, etc., in order to further relieve the tax burden for businesses. These highlighted measures are released to be in line with China’s business environment and address taxpayer’s concerns at the same time. Later on 7 March 2018, at a press conference held during the Annual Sessions of NPC & Chinese People’s Political Consultative Conference (CPPCC) for reporters from home and abroad (the “2018 Press Conference”), the Minister of the Ministry of Finance (MOF), Mr. Xiao Jie, Vice Minister Mr. Shi Yaobin and Mr. Hu Jinglin responded to a series of fiscal and taxation questions which are of interests to taxpayers, which include the IIT reform, legislation of property tax, as well as the policies on reduction of taxes and fees, etc.

In this issue of News Flash, we will introduce the highlights of the tax related measures and policies mentioned in the Report and share our observations.

In detail

Highlight one: Improving the local tax regime and steadily promoting the legislation of property tax

Xi Jinping, the general secretary of the Communist Party of China (CPC) Central Committee has specifically set forth the general requirement of “deepening the tax reform and improving the local tax regime” in his Report to the 19th CPC National Congress in 2017. This Report is released to echo his requirement of “improving the local tax regime”, in particular, another highlight is to "steadily promote the legislation of property tax and IIT reform".

As an area closely related to public interests and economic development, the property tax reform remains to be the key and difficult task of China’s tax reform. The Minister of the MOF, Mr. Xiao Jie has indicated the direction of China’s property tax reform in his interpretation of President Xi’s Report of the 19th CPC National Congress namely Accelerated Establishment of China’s Modern Fiscal Regime, i.e., to push forward the legislation and implementation of the property tax according to the principle of “legislation first, fully delegated power and progressing step-by-step”. Now the Vice Minister of the MOF, Mr. Shi Yaobin has revealed at the 2018 Press Conference that the Budgetary Affairs Commission of the NPC Standing Committee, MOF and other relevant ministries are accelerating the process of refining the draft property tax
law, and further shared the following key messages in relation to the property tax regime in China:

- Levying property tax based on the assessed value of residential housing owned by commercial businesses as well as individuals. Currently property tax is levied based on the original value of the industrial and commercial building discounted by a certain percentage. If property tax will be levied based on the assessed value, it reflects the common view of the general public from the consultation and is also consistent with international standards.

- The property tax regime will offer tax reductions and exemptions to families in difficulties, low-income families and groups with special difficulties.

- Property tax is a local tax and the property tax revenue belongs to the local-level governments. It is believed that the local-level government will have more flexibility in formulating their specific policies according to their own situations. The property tax will to a certain extent make up the revenue shortfall resulting from the abolishment of business tax, a major source of local tax revenue, after the completion of the B2V Pilot Reform.

- China will build a set of comprehensive tax administration mechanism to collect equitable and reasonable property tax. First of all, a well-established information system for individual property is necessary to the property tax collection. It will need the China’s Tax Administration and Collection Law (TACL) to add in corresponding tax administration and collection provisions on natural persons as the foundation for establishing such information system. Earlier, the Deputy Secretary-General of the NPC has indicated that China will again commence amending the TACL in 2018. It is therefore believed that the amended TACL will pave way for the successful implementation of property tax (and also the IIT reform) in the future.

**Highlight two: Raising the IIT monthly deduction threshold and introducing certain new specific expense deduction**

The IIT reform has been under the spotlight and remains to be the difficult task under the tax reform agenda of the Chinese government. Over the past years, the revision on the IIT law mainly concentrated on the threshold (i.e., the “statutory deductible amount” under the tax law) and applicable rates. Along with rapid development of China’s economy, modification on these items within the IIT regime plays a relatively limited role in promoting equitable taxation and moderating revenue distribution in China.

Now the Report not only stresses to raise the IIT monthly deductible threshold, but also proposes to provide new specific expense deduction such as children’s education expense, and medical expense for serious illness, etc., which will reasonably relieve the tax burden of the general public. These policies will help China progressively establish a deduction system based on its own development strategy and people’s specific burdens, which demonstrates China’s close attention to people’s livelihood and its principle of “allowing taxpayers to carry tax burden based on their capacity”. These new measures will allow individual taxpayers to carry a more reasonable tax burden, and this earmarks equitable taxation and allows IIT to positively moderate revenue distribution in China.

At the 2018 Press Conference, Mr. Shi Yaobin has also expressed that the specific IIT monthly deductible threshold and specific expense deduction would be determined according to the development of Chinese people’s basic consumption standards and other specific situations. Meanwhile, he reiterates that China’s overall objective is to improve the IIT collection model with the general principle of “establishing an IIT regime comprising of a combination of comprehensive and category taxation”, which is to say that certain income derived from provision of labour services such as wages and salaries, remuneration for labour services and for manuscripts, income derived from royalties will be combined as an individual’s comprehensive income and subject to IIT on a combined basis each year. However, the Report does not clarify the specific time schedule for implementing the comprehensive IIT reform in China.

**Highlight Three: further easing the tax burden of businesses**

- Further simplifying VAT rates: After the completion of the B2V Pilot Reform in 2016, simplifying the structure of VAT rates has become one of the main focuses of VAT reform. The 2017 Government Work Report has proposed to simplify the four VAT tax brackets into three and subsequently Caishui [2017] No. 37 was issued in April 2017 to cancel the VAT rate bracket of 13% and move the maximum 11% taxable activities to the VAT rate bracket of 11%. This year, the Report proposed to further simplify the tax brackets from three categories into two categories, and will prioritise to lower the tax rate of the manufacturing and transportation industry (which currently are applicable to 17% and 11% VAT rate respectively). It is expected that the fiscal and taxation departments will come up with measures to adjust VAT rates. However, whether the streamlining and combination of VAT rates structure will be implemented through a single undertaking or a step-by-step roll-out in different industries still remained to be further clarified by the fiscal and tax departments.

- Further boosting the upgrading of the real economy: The Report proposes to focus on reducing the tax burden of real economic industries. In addition to lowering the VAT rate of specific industries, the CIT deduction limit for new appliance and equipment purchased by enterprises may be increased significantly. The MOF’s Minister mentioned in the press meeting that the upper limit will be set under five million. Under the current regulation, the CIT deduction limit for the instruments and equipment newly acquired for the purpose of R&D is RMB one million. The significant increase in the deduction limit will encourage industrial upgrade, technological innovation, and improve the cash flow of businesses, so as to further boost the development of the real economy.
- Enhance the development of the small scale VAT taxpayers and small and thin-profit enterprises: The Report proposes to increase the annual sales revenue threshold amount for small-scale VAT taxpayers. According to the existing regulations, taxpayers with annual sales revenue below the threshold amount normally pay VAT as small-scale taxpayers but they can choose to register as general VAT taxpayers. Those with annual sales revenues over the threshold amount must register as VAT general taxpayers except under special circumstances. Raising the threshold amount of annual sales revenues provides the choice to more VAT taxpayers with annual sales revenue below the threshold amount so that they can choose to use the applicable tax treatment based on their own discretion, which helps to lower their tax burden. In the meantime, the threshold taxable income amount of small and thin-profit enterprise will be increased so that more enterprises can enjoy the 50% CIT rate preferential treatment. The scope of small and thin-enterprises eligible for this tax incentive has gradually been expanded in the past few years and the existing threshold taxable income amount is RMB500,000. This increase in the threshold amount would benefit more start-up enterprises.

- Improve the foreign tax credit (FTC) regime: The MOF and SAT have already issued Caishui [2017] No. 84 at the end of 2017 allowing taxpayers to choose to apply a “consolidated credit approach” (i.e. to calculate the FTC limit regardless of the source of the income and the basket of incomes). Moreover, an indirect FTC in relation to foreign dividend was expanded from 3 layers of qualified foreign subsidiaries to five layers. This “consolidated credit approach” policy allows taxpayer to balance tax burden among subsidiaries located in different countries/jurisdictions and increase its creditable FTC amount, which will effectively reduce the total tax burden on the foreign income of Chinese enterprises. It is expected that the fiscal and taxation departments will release a set of detailed rules to implement the policy.

- Extend the applicable period and range of the preferential treatment of land-related taxes: The Report proposes to extend the applicable period of preferential policies on land transactions in enterprise restructing, including land appreciation tax and deed tax. According to the existing regulations, the transfer of state-owned land and buildings during the change in form of enterprises, merger, spin-off, and reorganisation of enterprises is eligible for land appreciation tax deferral treatment. In the meantime, transfer of land and buildings during the reorganisation of enterprises and public institutions are eligible for deed tax exemption. These preferential policies were scheduled to expire at the end of 2017. In addition, The Report also proposes to allow more logistics enterprises to enjoy the 50% reduced land usage tax rate on the use of land for storage facilities.

**Highlight Four: expand the applicable range of preferential tax treatment for venture capital enterprises and individual angel investors**

This incentive refers to the preferential tax treatment that allows venture capital enterprises and individual angel investors that invest in start-up technological enterprises through equity investment to deduct a certain percentage of their investment amount if certain requirements are met. This is designed to encourage more investors to invest in start-up companies. This policy was promulgated in 2017 and currently only applicable in certain piloted areas such as “Beijing-Tianjin-Hebei” region and Shanghai. With the rolling out of this policy nationwide, it is expected that more capital will be attracted to invest in start-up companies by this tax incentives, which will boost economic growth and create new opportunities for employment.

**The takeaway**

In recent years, China has put high priority on the reform of turnover tax, especially on VAT. However, the reform of property tax and IIT, which is directly related to public interest, has been progressing at a comparatively slow pace. Therefore, the legislation of property tax and the reform of IIT mentioned in The Report is undoubtedly the main focus of the public, which is giving out a signal of accelerating and deepening the reform.

In addition, there is no doubt that China will continue to reduce the burdens of tax and levies, which can be seen from the multiple tax and levies reduction policies and measures put forward in The Report. The Report proposes that the government will continue to carry out measures to reduce the tax and non-tax burdens on businesses and individuals by more than RMB 800 billion and more than RMB 300 billion respectively. Moreover, China will keep improving the business environment. The State Council has set out certain measures to attract foreign investment in 2017. Fiscal and tax related supportive polices have already been unveiled, which proved to have a positive impact on improving the business environment, stabilising foreign investment and responding to the spill-over effect caused by US tax reform. Prime Minister Li Keqiang emphasised in the Standing Committee Meeting of State Council held in the beginning of 2018, that the business environment will be further improved by streamlining administration and reducing tax and levies. The government will study international practices and speed up the building of the business environment evaluation mechanism and rolling it across the country. We believe that the Chinese government will continue to deepen the reforms designed to delegate powers, improve regulation and services to create a law governing business environment which is consistent with the international practice to increase China’s overall competitiveness in the world.

Companies and individuals should pay close attention to the fiscal and taxation highlights in The Report to see if they are eligible for the incentives covered by the policies. Although not every company or individual is eligible for the incentives in the short term, we believe they will eventually benefit from the increasingly improved tax and business environment.
Notes
1. Government Work Report in 2018
   http://www.gov.cn/premier/2018-03/05/content_5271083.htm
2. Minister Xiao Jie of Ministry of Finance Meets the Press on Fiscal and Tax Reform and Fiscal Work on March, 7th, 2018
   http://www.guancha.cn/economy/2018_03_07_449207_s.shtml
3. Accelerated Establishment of China’s Modern Fiscal Regime issued by Minister Xiao Jie of Ministry of Finance as an further interpretation of President Xi Jinping’s Report at the 19th CPC National Congress
   http://www.mof.gov.cn/zhengwuxinxi/benbugaikuang/buzhangzhichuan/g/xjbz/zywg/201712/t20171220_2782040.html
4. Press Meeting of the First Session of the 13th National People’s Congress of PRC on 4 March 2018
5. Public Notice Issued by the SAT Regarding Certain Matters Related to Accelerated Depreciation Methods of FA for Tax Purposes (partially invalid) (Public Notice [2014] 64) and Notice Jointly Issued by the MOF and SAT Refining the Accelerated Depreciation Methods for CIT Purposes (Caishui[2014] 75)
6. Article 28 of Detailed Implementation Rules of the Provisional Regulations on Value-added ("VAT") Tax of the PRC (2011 Revision) and Appendix 2 of Notice Jointly Issued by the MOF and SAT on the Comprehensive Roll-out of the B2V Transformation Pilot Program (the “B2V Pilot Program”) (Caishui [2016] 3)
7. Notice Jointly Issued by the MOF and SAT Expanding the Eligible Scope of Small Thin-profit Enterprises (STE) for CIT Preferential Treatments (Caishui[2017] 43)
8. Notice Jointly Issued by the MOF and SAT Regarding the Land Value Added Tax (LVAT) Treatment for Corporate
   Transformation and Restructuring (Caishui [2015] 5)
11. Notice Jointly Issued by the MOF and SAT Regarding the Pilot Tax Policies of Venture Capital Enterprises (VCE) and Angel Investors (AI) (Caishui[2017] 38)
News Flash — China Tax and Business Advisory

Let’s talk

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