The final stage of the B2V Reform to be rolled out from 1 May 2016

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In brief

Since 1 January 2012, the State Council has launched the pilot programme for the transformation from Business Tax (BT) to Value Added Tax (VAT) in stages in China (the “B2V Reform”), in order to improve the input VAT credit mechanism, mitigate the multiple taxation issue and promote the economic upgrade. By the end of 2015, the B2V reform has been completed for the transportation, certain modern services, postal services, and telecommunications industries, etc. However, the remaining four industries, namely the construction sector, real estate sector, financial services and consumer services have so far not been included in the B2V Reform partly because of the slowing down of China’s economic growth, and partly because of the complicated B2V policy relating to the four remaining industries. On 5 March 2016, at the fourth session of the 12th National People’s Congress (NPC), Premier Li Keqiang announced in the government work report (the “Work Report”) that the B2V Reform will be further rolled out to cover the remaining four industries starting from 1 May 2016. Following that, the Minister of the Ministry of Finance (MOF), Mr. Lou Jiwei shared his views in the Q&A session of a press conference held on 7 March in respect of the implementation date of the final stage of the B2V Reform, reduction of tax burden to taxpayers, and input VAT credit for immovable properties, etc.

In detail

The B2V Reform will cover all industries from 1 May

Premier Li Keqiang indicated in the Work Report that “Starting from 1 May, the B2V Reform will be expanded to cover the construction, real estate, financial services and consumer services, which signifies the completion of the B2V Reform within this year. Meanwhile, the input VAT incurred by all enterprises on newly acquired immovable properties will be allowed to be credited in order to ensure that the tax burden of all sectors will be reduced with the completion of the B2V Reform”. The Minister of MoF, Mr. Lou, described the above task as a “Military Order”. It implies that all the relevant government authorities will make sure that the final stage of the B2V Reform is completed as scheduled despite of all the difficulties that they would encounter. As such, the long-awaited four-year B2V Reform will be officially completed and China’s indirect tax system introduced in 1994 comprising of both VAT and BT will become history by then. The B2V Reform will serve as a solid foundation for China to further improve her VAT regime, optimize the allocation mechanism of its fiscal resources between the central and local governments, and accelerate the process on the enactment of the VAT law.

The final detailed rules would be released soon

The timing of the release of the final implementation rules is under the spotlight following Premier’s announcement. Looking back at the previous stages of the B2V reform, there were usually around seven to ten working days between the date of official announcement and the date of the release of the detailed B2V policy. Taking the effective date of 1 May into consideration, it is anticipated that the detailed B2V rules may be released in the mid of March. Although taxpayers in the relevant industries have been expecting the advent of this final stage of the reform and taxpayers in these sectors, such as the banking sector, have already started their preparation. However, a lead time of approximately 50 days does not seem to be sufficient for taxpayers to get prepared due to the special features and complexity of the industries involved in this final stage.

Tax burden of industries should be generally reduced

The Work Report indicated that the tax burden of all the industries should generally be reduced, which is appealing to taxpayers. Meanwhile, the Work Report also disclosed that “there will be an increase of deficit amounting to RMB 560 billion this year, which will mainly be attributed to the reduction of taxes and fees aiming to further alleviate the
financial burden of enterprises”. It demonstrates the government’s strong determination to reduce the tax burden of taxpayers. Nevertheless, how to assess the change in short-term and long-term tax burden of taxpayers is rather complicated considering factors such as the unique characteristics of the VAT regime, impact of the unfinished contracts, timing for claiming input VAT credit incurred for newly purchased assets, and business’ operation cycle and etc.. In addition, although based on the effects of previous pilot runs and official statistics, the tax burden of taxpayers as a whole has been reduced, it is inevitable that the tax burden of certain taxpayers will increase in the initial stage of the reform. In response to this concern, Minister Lou explained that when looking at all the industries as a whole, the tax burden will be reduced. However, in terms of an individual enterprise, its tax impact should be assessed on a long-term basis. Despite of the possible increase of tax burden in the initial stage, the tax burden of an enterprise will be gradually reduced after a certain period of time when it continue to expands it business and increases investments. In summary, “the tax burden of all the industries as a whole would not be increased, but it is not necessarily true for each and every enterprise when it is in the final enterprise in a VAT chain.” That said, we recommend that enterprises should assess the change of its tax burden on a case-by-case basis.

**Input VAT incurred for newly acquired immovable properties can be creditable**

The Work Report also indicated that “the input VAT incurred by all the enterprises on newly acquired immovable properties would be creditable”, which is welcome as it can improve the tax credit mechanism and mitigate the multiple taxation issue. According to Minister Lou, “there will not be any input VAT credit for immovable properties acquired prior to the B2V Reform”. This appears to indicate that there may not be any transitional relief for immovable properties already acquired by taxpayers. Moreover, the current VAT credit mechanism adopts the principle of allowing input VAT credit to be claimed for purchases for the current period, that is, taxpayers can claim input VAT credit on receiving valid VAT invoices from suppliers regardless of when the corresponding revenue is recognized. However, considering the large amount of input VAT credit on immovable properties, the one-off credit could possibly result in an imbalance of tax in different tax periods. It is possible that the input VAT credit of immovable properties could be creditable in instalments to match with the realization of income.

**The takeaway**

Relevant parties are eagerly waiting to see how the following tax issues that have received a lot of attention during the policy drafting stage are resolved in the final detailed rules:

- Whether financial enterprises will fall within the scope of consolidated VAT filing, and whether input VAT incurred on interest expenses will be creditable?
- How to determine the timing of VAT liability and tax basis of presale revenue for real estate enterprises and how to claim the input VAT credit for the land cost?
- Will taxpayers be allowed to choose the simplified VAT calculation method for unfinished contracts?
- Will there be more detailed measures for enterprises engaged in mixed operation to facilitate tax administration in this regard? Will the new rules clarify the VAT treatment for certain special business models such as “free gift with purchases”, “rent free period”, etc.?
- Will the consumer services sector in principle be allowed to adopt the simplified VAT calculation method according to the circular Caishui [2011] No.110?

In addition, the completion of the B2V Reform is expected to bring about a series of changes on VAT policy and administration which will have profound impacts to business:

- Currently, there are five types of VAT rate in China, i.e., 17%, 13%, 11%, 6% and zero rate. Will certain VAT rates for certain industries combined to reduce the VAT burden of certain industries in the future?
- The current VAT returns are designed mainly for the reporting and levying VAT on goods and services. Will the VAT returns be completely revised to better fit in with the characteristics of the various taxable services?
- How will the VAT administration by the tax authorities be revised and re-allocated upon the completion of the reform, and how will taxpayers comply with the changes?
- The Law has already been included in the legislation enactment pipeline and will proceed when the timing is ripe.

Before the release of the detailed rules, taxpayers in the relevant industries are highly recommended to consider the following:

- Impact analysis- Starting from analysing the difference between BT and VAT, taxpayers should review their current business, analyse the operation model and the structure of their taxes and expenses, enhance their price bargaining power, investigate suppliers’ profile and improve supplier management;
- Contract review- Taxpayers should review their current contracts and adjust according to the B2V policies, in particular, review the legality of the tax related clauses and develop standard contract clauses after the completion of the B2V Reform;
- System revamp- Taxpayers should revamp their systems to enhance VAT risk control, proactively prepare the system revamp for separating price and VAT as well as the accounting requirements under the VAT regime.
- Training- Taxpayers should improve the internal tax administration and internal tax risk control, provide further trainings to personnel in the finance, tax and other relevant departments, and get to understand the new policies and operation mode of VAT management as soon as possible.

Upon the release of the detailed rules, we will issue specific topic reports providing analysis and impact studies on tax and business operation issues faced by industries affected by this final stage of B2V reform. Please stay tuned for our China Tax and Business News Flash and other publications.
For a deeper discussion of how this issue might affect your business, please contact a member of PwC’s China Indirect Tax Team:

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