China’s top leadership reaffirms the taxation reform blueprint

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In brief

The 18th Central Committee of the Communist Party of China (CPC) held its third Plenary Session (the Third Plenum) from 9 to 12 November 2013 in Beijing. At the Third Plenum, the Decision on Several Major Issues Concerning the Comprehensive Deepening of Reform (the Decision) was adopted by the Committee. The Decision sets out the general plan for a package of political and economic reforms in China to be achieved by 2020 as well as the objectives and guidelines of these reforms.

The fiscal and taxation reforms in the Decision are generally consistent with those outlined in the 12th Five-Year Plan from two years ago. Some of the reforms have already been under pilot implementation, such as the Business Tax (BT) to Value-added Tax (VAT) Transformation Pilot Programme (B2V Transformation Pilot Programme) and the pilot run of Property Tax collection in Shanghai and Chongqing, while some are still under discussion, like the introduction of Environmental Tax and the optimisation of Consumption Tax (CT). The Decision also commits to strengthen the legislation of tax incentives and improve the relevant administration. Relevant taxpayers, companies and investors should keep close attention to the taxation reforms highlighted in the Third Plenum and plan ahead.

In detail

Objectives

According to the Decision, the taxation reforms aim to improve the taxation system in China, stabilise the tax burden of taxpayers, improve the efficiency in tax administration, enhance social equity and allocate resources more fairly. For this purpose, the government will transform its taxation system by enhancing tax revenue sharing between the central and local governments and gradually increasing the ratio of tax revenue derived from direct tax and promoting VAT reform.

Meanwhile, certain new taxes, e.g. Environmental Tax, are considered to accommodate some of the new initiatives.

Enhance tax incentives administration

While most of the taxation reforms are a continuation of those under the 12th Five-Year Plan, it is worth noting that the Decision also emphasises the need to reinforce and standardise the administration on tax incentives, in particular local and regional incentives. The Decision also refers to a plan to review existing tax incentives and reiterates that all tax incentives shall be formulated under a unified national tax regulation.

This new agenda may imply the top leaders’ guidance on granting of tax incentives. The new Corporate Income Tax (CIT) Law that came into effect in 2008 no longer provides region-specific tax incentives. Instead, it encourages industry-specific tax incentives to boost industries that are in line with the nation’s economic mode transformation programme. However, in order to attract investment, some locations in recent years have offered tax incentives that are not specified in the CIT Law. It is possible that these local incentives could be a target of this new agenda which, as indicated in the Decision, may be intended to promote fair competition among various regions.

Other taxation reforms

Most of the other taxation reforms in the Decision have basically followed the roadmap in the 12th Five-Year Plan with some fine tuning.

- Deepen the reform of Indirect Taxes. The taxable scope of CT will be expanded to high energy-consuming and heavy-
polluting goods as well as certain luxury goods. In addition, the stage at which CT will be levied and the rate of CT for these goods will also be adjusted. Furthermore, the B2V Transformation Pilot Programme will also continue and the applicable tax rates will be appropriately simplified.

- **Reform Resource Tax and introduce Environmental Tax.** Reform of Resource Tax will be accelerated probably by extending the taxable scope to the use of most natural and ecological resources. Meanwhile, a new Environmental Tax may also be introduced to substitute the current fee levied on pollutant emission. These two taxes will be instrumental in promoting energy conservation and environment friendly industrial restructuring.

- **Introduce legislation for Property Tax.** The Decision pledges to accelerate the legislation of Property Tax and push forward relevant reforms. Currently, Property Tax, as one of the means to curb real estate speculation, has been implemented on a trial basis in the city of Shanghai and Chongqing. It seems that the Decision now intends to legitimate the legal basis for imposing Property Tax across the country. In addition to Property Tax, the reform might also cover other taxes relating to real estate, such as Land Value Appreciation Tax, Urban Land Use Tax, etc.

- **Revise Individual Income Tax regime.** The taxation of individuals will gradually migrate from the existing income category method to a combination of comprehensive income and the income category method. This echoes the theme to reasonably allocate social wealth in the Decision.

**The takeaway**

The Decision sets the general direction of where China’s fiscal and taxation reform is heading to. Investors should review their long-term development plans in response to these important reforms outlined by China’s top leadership. For example, companies engaged in high energy-consuming activities should closely monitor the proposed adjustment of CT, the refinement of Resource Tax and the introduction of Environmental Tax. Also, the new agenda in the blueprint about legislating tax incentives should be an indicator for investors to plan or revisit the tax implications of their potential or existing investments.

It is expected that more waves of reform actions as well as the detailed scope and timeline for each reform will be unveiled by the relevant government authorities in the near future. Keeping a close dialogue with the relevant governing bodies or industrial associations will be beneficial to assess and prepare for the possible challenges and impact on business.

**Endnote**

Let’s talk

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