

Asia Pacific Tax Newsalert

A Washington National Tax Services (WNTS)
Publication

CHINA

November 7, 2011

China's Indirect Tax Regime Reform

In connection with the Chinese government's efforts to rectify the perceived inefficiencies of the existing indirect tax system, the State Administration of Taxation ("SAT") and the Ministry of Finance ("MoF") have announced a trial run for indirect tax reform in Shanghai.

This Newsalert summarizes the key aspects of proposed Shanghai pilot program.

Shanghai Pilot Program

The government will introduce a pilot program in Shanghai, for selected industries to gradually expand the scope of Value Added Tax ("VAT") to include industries that are currently subject to Business Tax ("BT"). The pilot program would effective January 1, 2012.

- **Covered industries:** The program will apply the VAT rules to the transportation industry and some modern service industries ("Pilot Industries") in Shanghai. Eventually the program will expand to these industries country-wide.
- **Range of VAT rates:** In addition to the current 17% and 13% VAT rates, two additional VAT rates, 11% and 6% will be added to the pilot program.



-
- **Credit mechanism:** The Pilot Industries that will be subject to VAT will be entitled to an input credit.
 - **Continuity of existing preferential BT treatments:** BT incentives for the Pilot Industries may continue but will be adjusted according to VAT.

Our Observations

The transformation from BT to VAT will impact not only service industry companies but also the companies buying services in their value chain. Some impacts of the proposed changes are set out below:

- This change will likely reduce the indirect tax liabilities for BT payers in the Pilot Industries (e.g., service providers). The input VAT incurred will now be creditable and the BT which they previously had to pay will become VAT which they will collect from their customers. This change would impact the service providers' Profit and Loss Account as theoretically BT should no longer appear as cost of sales.
- For the service providers' customers, who will also become the VAT payers, this may be a welcome change as the VAT paid is now creditable, while previously the BT paid was not creditable against the output VAT. However, this may not always be the case; for instance, currently there is a 7% deemed input VAT credit for transportation services where there is a valid transportation BT invoice. The creditable VAT under the pilot program could be less. On the other hand, if the customer is a BT payer, VAT charged by such service providers may be an additional cost to the customer (comparing the new VAT rates of 11% and 6% against BT rates of 3% and 5%).
- Even though the Pilot Program will only be implemented in Shanghai, those BT payers in the Pilot Industries will inevitably have business dealings with customers and suppliers in other provinces. The impact of the Pilot Program to non-Shanghai customers is currently not known.
- The main implications for the Pilot Program participants is the likely change to their operational systems in order to capture all information required for VAT compliance purposes. Companies will need to consider how to collect the necessary information from customers to issue VAT invoices; when and how to issue VAT invoices and credit notes; how to report and account for VAT; whether their ERP systems generate the necessary information for VAT compliance (reprogramming ERP systems is time consuming); staff training; how to handle existing contracts, etc.

Preparing for the transformation requires considerations of commercial, operational and technical issues. With fewer than three months remaining, companies should consider these and other issues.

For more information, please do not hesitate to contact:

Your international tax service team in the U.S.

Rebecca Lei Wang (646) 471 7384 rebecca.l.wang@us.pwc.com

Your International tax service team in China

Alan Wu (8610) 6533 2889 alan.wu@cn.pwc.com

Robert Li (8621) 2323 8888 robert.li@cn.pwc.com

Liang Gong (8621) 2323 8888 gong.liang@cn.pwc.com

Cindy Li (8621) 2323 8888 xiuling.li@cn.pwc.com

Janet Xu (8621) 2323 8888 janet.xu@cn.pwc.com

This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

SOLICITATION

© 2011 PricewaterhouseCoopers LLP. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.