

## Expansion of the VAT Reform Pilot

### **The Pilot Scope of the Reform from Levying VAT Reform Pilot Business Tax (“BT”) to Value-added Tax (“VAT”) was expanded**

The Premier of the State Council, Mr. Wen Jiabao, presided over an executive meeting of the State Council on 25th July 2012, at which the State Council decided to expand the pilot scope of the reform from levying BT to VAT. During the meeting, the State Council decided to expand the reform pilot to another 10 provinces/cities, including Beijing, Tianjin, Jiangsu, Zhejiang, Anhui, Fujian, Hubei, Guangdong, Xiamen and Shenzhen, as of 1st August 2012. The pilot project for the reform was firstly conducted in Shanghai in the transportation sector and part of the modern service sector. The State Council also decided to keep on expanding pilot areas next year and choose parts of industries to make pilots nationwide.

In accordance with the decisions of the meeting, on 31st July 2012, the Ministry of Finance and State Administration of Taxation jointly issued the Notice About Pilots of Reform from Levying BT in Transportation Sector and Part of Modern Service Sector to VAT in 8 Provinces and Cities Including Beijing, by which Beijing and Tianjin have been formally covered by the pilot areas of tax reform,

and the sectors in which pilots are made include fields such as transportation sector and shipping service sector etc. With the expansion of the pilot scope, it is clear that the reform from levying BT to VAT represents the general trend which conforms to long-term needs.

### **Basic Provisions**

At the beginning of the pilot project, the Ministry of Finance and State Administration of Taxation promulgated on 16th November 2011 Measures for the Implementation of Pilots of Reform from Levying BT in Transportation Sector and Part of Modern Service Sector to VAT (hereinafter referred to as “the Measures”), and set up a pilot in Shanghai. In accordance with the Measures, the companies and individuals providing services in the transportation sector and part of the modern service sector (hereinafter referred to as “taxable services”) in the territory of the People’s Republic of China (hereinafter referred to as “China”) are taxpayers of VAT. Taxpayers shall pay VAT for providing taxable services but not BT any more according to the Measures. Taxable services include those provided by the companies or individuals outside of China.

Article 12 of the Measures stipulates that the rates of VAT are as below:

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1. Where a lease service of tangible personal property is provided, the rate is 17%. (Bareboat within this category.)
2. Where service of transportation sector is provided, the rate is 11%. (Both voyage charters and category.)
3. Where services of the modern service sector are provided (except for lease service of tangible personal property) (Including services at ports and wharf, services at cargo and passenger transport stations, shipping agency services, storage services and loading and unloading services)
4. Where taxable services stipulated by the Ministry of Finance and State Administration of Taxation

## Effects of the Reform

The reform has strengthened the supervision over tax revenue of the shipping sector to some extent. Before the reform, in order to avoid business tax, some companies often adopt means such as opening personal accounts and other means to transfer money so as to decrease the turnover in accounting books and ultimately avoid business tax. After the reform, as cargo and transport service receivers are taxpayers of VAT prior to the reform, they will certainly require shipping companies to issue VAT invoices in the course of receiving shipping services after the reform. Under such circumstances, shipping companies will scarcely avoid taxes again.

On the other hand, shipping companies will have the opportunity to apply for the input tax deduction of BT. This provides an opportunity of lessening or reducing burden on shipping companies.

## Further Clarifications Required

However, we note that the rates of VAT stipulated in the Measures are not unified, which causes confusion, influencing whether it will really relieve the burden of taxation on companies or not.

### 1. Whether the rates are suitable

The Measures stipulate that the VAT rate in transportation sector is 11%, and that of the shipping sector is 17%. In accordance with the Provisional Regulations on Business Tax, the rate of BT in the transportation sector is 5%. In the course of the pilot in Shanghai, many shipping and logistics companies

not been lightened, but even increased under some circumstances.

The Ministry of Transport of China has drawn up Opinions on Further Perfection of the Reform of the Value-added Tax of Shipping Companies (hereinafter referred to as the “Opinions”). The Opinions stipulate that the VAT rate for the transportation sector shall be fixed at about 6-7%. Compared with the present 11% VAT rate, this is 50% lower.

## 2. Coordination with the original national and local tax preferential policies

With regard to the construction of the international shipping center, both the central and local governments have issued many policies that support the shipping sector and shipping service sector, among which are many preferential policies in those sectors. For instance, the preferential policies for Dongjiang Free Trade Port Zone of Tianjin issued by Tianjin government, etc. Therefore, issues with respect to how these policies are coordinated with the new VAT to VAT and how to regulate the original tax preferential policies deserve attention and consideration.

## 3. Arrangement about the taxable services of foreign companies and individuals in China

With regard to the taxable services of foreign companies and individuals in China, the Ministry of Finance, State Administration of Taxation, China and State

Administration of Taxation issued the Supplementary Notice About Tax Policies for the Pilot Scope of the Reform of Business Tax to Value-added Tax of Transportation Sector and Part of Modern Service Sector. It stipulates that where any company or individual in any country or region, which has not reached any bilateral tax exemption arrangement with the Chinese government, renders international transportation services to and from China, for which Article 6 of the Measures (CS [2011] No.111) is applicable, the withholding agent shall pay the VAT according to the Measures during the period of the pilots.

In order to prevent those taxes, such as business tax or income tax, etc. from being levied by the local governments which have not reached the bilateral transportation tax exemption arrangement or agreement with many countries, the supplementary notice clearly stipulates that any company or individual in any country or region which has not reached an exemption arrangement with China shall pay the VAT for the taxable services rendered in China. It also stipulates how to levy taxes on those companies or individuals in countries or regions which have reached an exemption arrangement with China.

Moreover, with regard to any country or region which has not reached a tax exemption arrangement with China, for international transportation services rendered in the aforesaid pilot scope, the tax rate of 11% will be applicable. This rate is higher than the business tax of 3% in other non-pilot areas.

In summary, there is no doubt that the purpose and the final results of the reform from levying VAT on shipping companies. However, we should also pay close attention to some problems arising during the reform in time once the true effects of the reform can be seen.

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