

Webcast

Asian Tax & Advisory Webcast Series

China's VAT Reform and Indirect Tax Adjustments in Time of Financial Crisis

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Note: During the live Q&A session, please submit all questions in English only.

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China's VAT reform and Indirect Tax adjustments in time of financial crisis

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Agenda

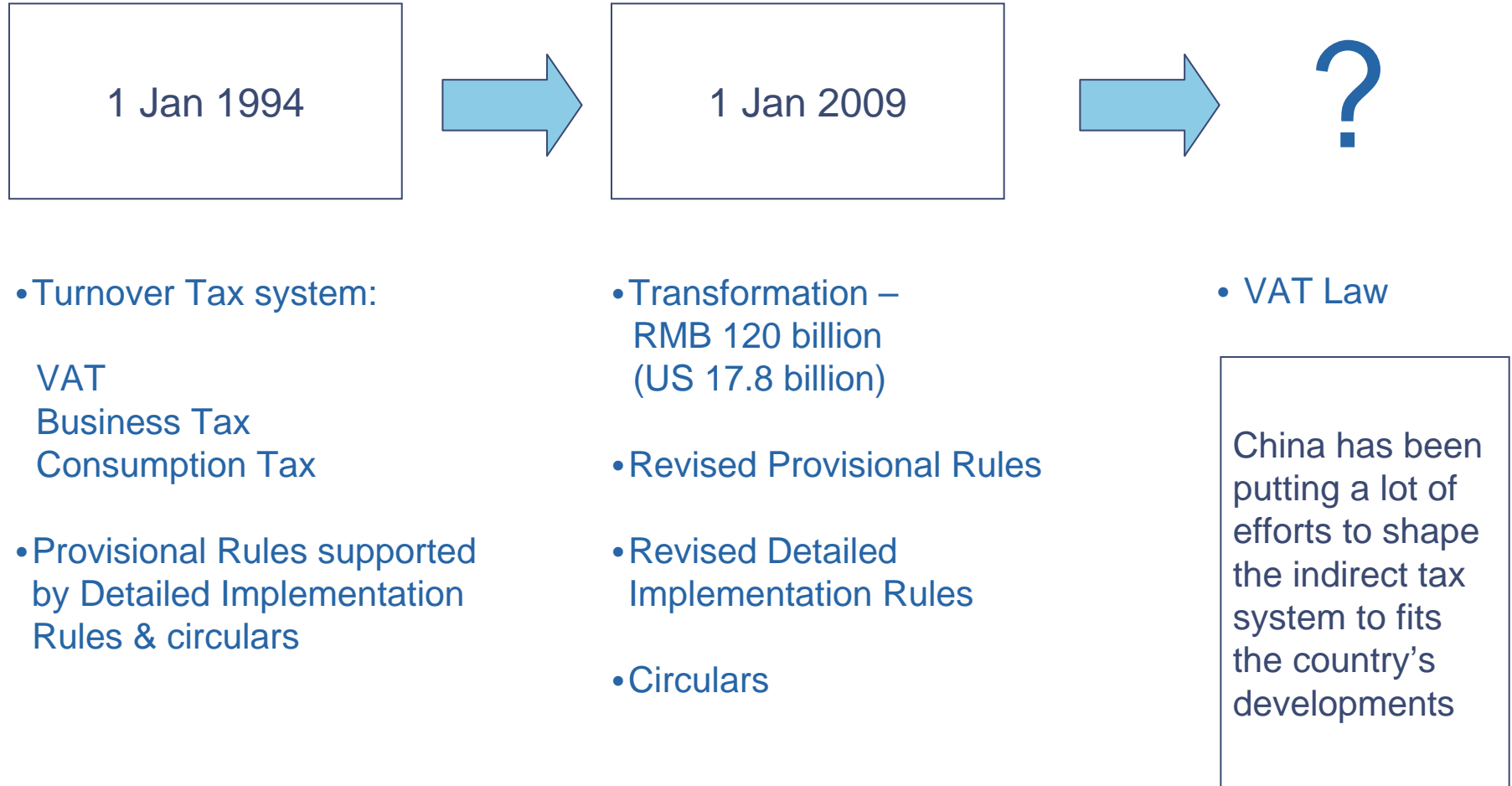
- Overview of China indirect tax regimes
- VAT reform
- Update on export VAT refund policies
- Adjustments to other indirect tax regimes
- Possible developments in future
- Conclusion
- Q&A

Please submit all questions in English only.

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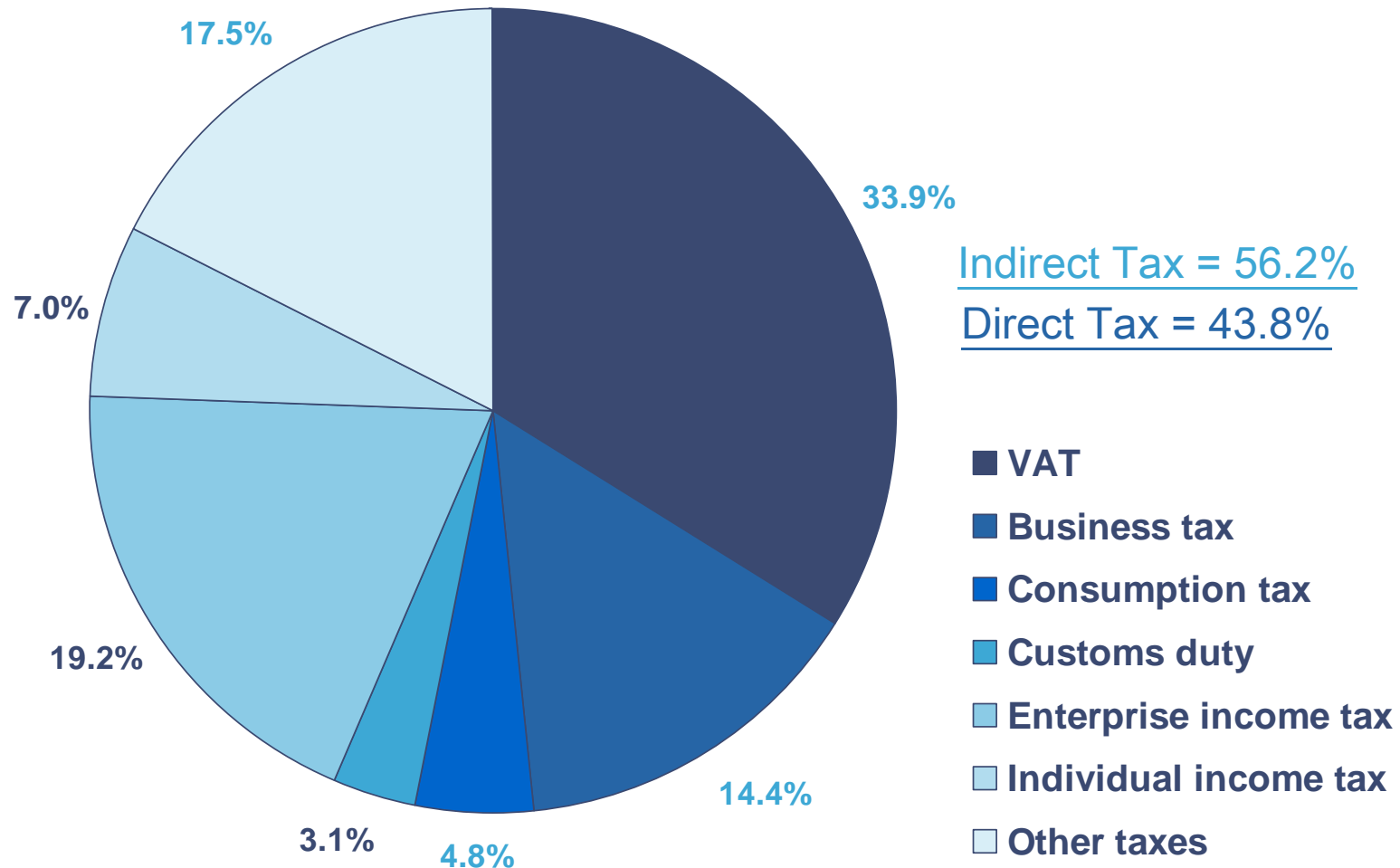
Overview of China indirect taxes

Development of Chinese indirect taxes



Overview of the VAT

Year 2007: Composition of China Tax Collection



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VAT reform

Transformation from "production-base" to "consumption-base"

- Will come into force on Jan 1, 2009
- Transformation has been set out in the revised Provisional Rules of the People's Republic of China on Value-added Tax issued on Nov14, 2008
- Rationale:
 - Part of a RMB 4 trillion (US 586 billion) “Economic Stimulation Plan”
 - Welcoming move
 - Stimulate investment
 - Promote domestic consumption
 - Encourage technologic enhancement
 - Support struggling businesses to withstand financial crisis

Transformation from "production-base" to "consumption-base"

- Transformation will include the following features:
 - Country wide application
 - Industry wide application
 - Full amount of input tax recovery
 - Applicable on new purchase of “fixed assets”
 - Carry forward of excess input VAT (no refund?)

Transformation from "production-base" to "consumption-base"

Position	Transformation
Implications	<ul style="list-style-type: none"> • Good news to businesses planning to make further investment in “fixed assets” – recovery of input VAT will lower the cost of investment • No refund feature means added item on balance sheet • Minimise multiple taxation • Benefit may not come immediately due to timing difference b/w output VAT and input VAT (e.g., when starting a new manufacturing plant)
Action	<ul style="list-style-type: none"> • Modify procurement plan (i.e., buy on or after Jan 1, 2009) if commercially viable – to be benefited from the Transformation

Transformation from "production-base" to "consumption-base"

- Areas yet to be clarified:
 - The type of “fixed assets” to be included
 - Administrative aspect of the input VAT recovery – need new house keeping measures (e.g, reporting procedures, supporting requirements)
 - The input tax recovery of “fixed assets” of mixed uses (e.g., Businesses use “fixed assets” to make both VATable and BTable supplies. Manufacturers make to sell domestically and provide VAT-exempt tolling services)
 - VAT treatment regarding change of use of “fixed assets” of which input VAT have been recovered

Cancellation of preferential VAT treatments

1. Cancellation of import VAT exemption treatment for imported equipment
 - Equipment imported for toll processing, assembly or compensation trade
 - Equipment imported for encourage projects

2. Cancellation of VAT refund treatment of “domestically-made” equipment purchased by FIEs

Cancellation of preferential VAT treatments

Position	<p>Cancellation of import VAT exemption treatment for imported equipment</p> <p>Cancellation of VAT refund treatment of “domestically-made” equipment purchased by FIEs</p>
Rationale	<p>Non-advantageous to domestic equipment development</p> <p>Unfair tax burden between foreign investment enterprises and domestic enterprises</p> <p>Input VAT allowed as a credit</p>
Implications	<p>Raise procurement costs for some businesses that are not registered as General-VAT taxpayers (e.g., R&D, Transportation)</p> <p>Cash flow pressure for some businesses that are of export orientated nature (e.g., no or low level of output VAT)</p> <p>Cash flow pressure for some businesses with high initial capital investment (e.g., timing difference between input VAT credit and output VAT)</p>
Uncertainty	<p>Possibility of grandfathering or special concession?</p>
Action	<p>Import / purchase the required equipment and complete the VAT exempt / refund formalities before the cancellation comes into effect, if commercially viable</p> <p>Rethink of supply chain model</p> <p>Stay tune for development regarding grandfathering or special concession</p>

VAT reform – surrounding components

- In addition to the Transformation, other changes are brought by the revised Provisional Rules
 - Input VAT creditable with respect to purchase of agricultural products (revised rate of 13% vs old rate of 10%)
 - Deemed input VAT on the freight charges paid for purchasing or selling goods and for manufacturing now included in Provisional Rules
 - Reduced VAT rate of 3% for the small-scale VAT taxpayers. Currently, VAT rates are 4% (for commercial enterprises) and 6% (manufacturing and other enterprises)
 - Introduce new quarterly VAT payment period. Under the old rules, the longest VAT payment period was one month
 - Monthly and quarterly VAT return filing and payment should be made 15 days (was 10) after the end of each VAT payment period

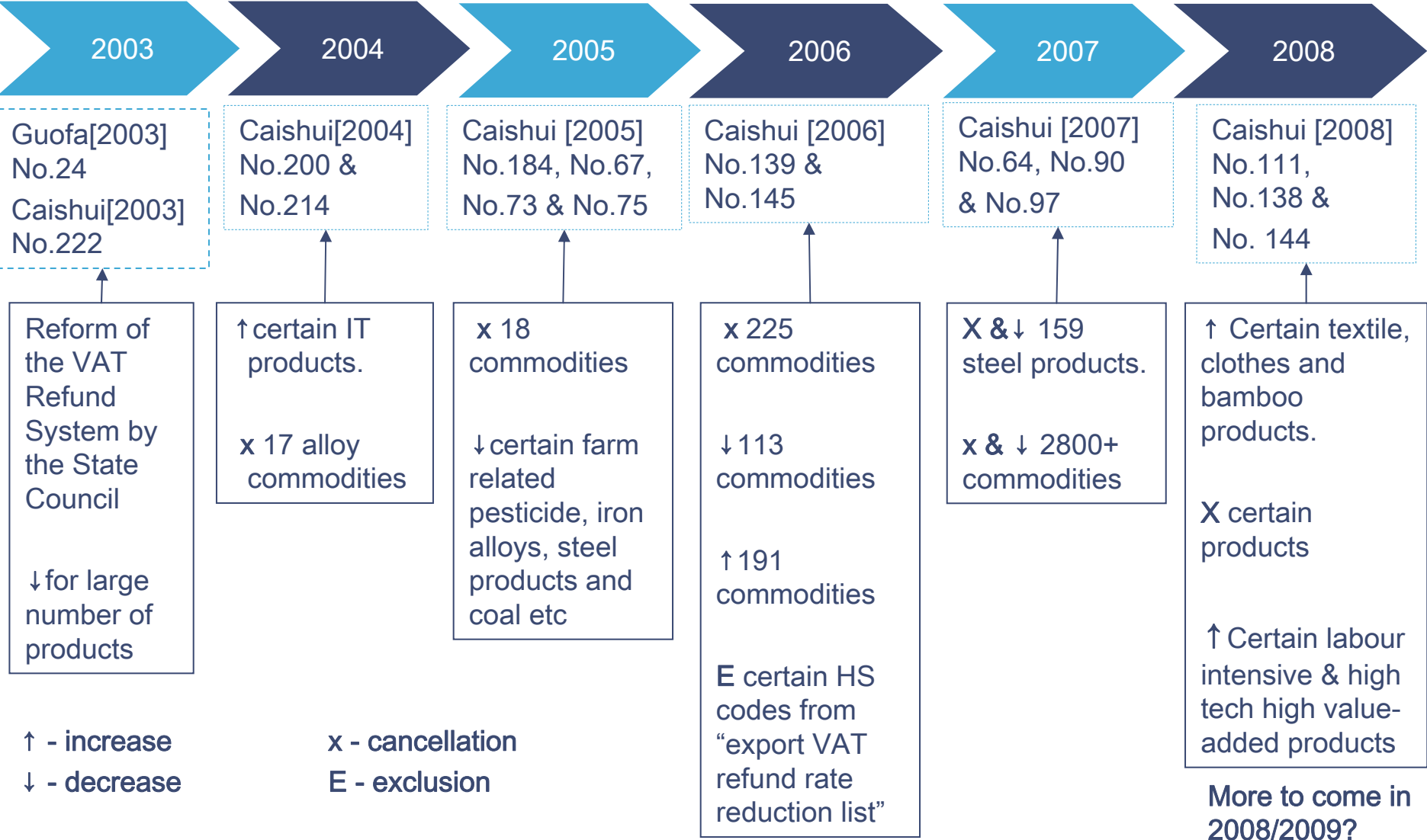
VAT reform – what's next?

- What is happening now?
 - Revising Detailed Rules for the Implementation of the Provisional Rules of the People's Republic of China on Value-added Tax
 - Tidying up old circulars which would contradict the revised Provisional Rules and Detailed Rules
- What's next?
 - Promulgation of the revised Detailed Rules
 - Issuance of circulars which cancel old, redundant circulars and set out further details that are not covered by the Detailed Rules

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Update on export VAT refund

Trend of Export VAT Refund Rates Adjustments



Update on export VAT refund

Position	Fluctuating export VAT refund rate Export VAT refund is on an upward trend under the current financial crisis
Implications	Increase in export VAT refund rate will help lower the export costs On the other hand, decrease in export VAT refund rate will increase the export costs, less competitive
Action	Evaluate impacts caused by the changes Make changes to the manufacturing supply-chain where necessary (e.g., BLP, export via trading company?) In some cases, businesses may consider: Revisit the HS code etc.

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Adjustments to other indirect tax regimes

Adjustments to other indirect tax regimes – what's next?

- Revised Provisional Rules of the People's Republic of China on Business Tax and Provisional Rules of the People's Republic of China on Consumption Tax issued on Nov 14, 2008
- What is happening now?
 - Revising Detailed Rules for the Implementation of the Provisional Rules of the People's Republic of China on Business Tax and Detailed Rules for the Implementation of the Provisional Rules of the People's Republic of China on Consumption Tax
 - Tidying up old circulars which would contradict the revised Provisional Rules and Detailed Rules
- What's next?
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Potential development in future

Overview of potential VAT development

- Reform of the current VAT system & upgrading of the above rules to VAT Law have been identified as important tasks
- Likely approach: Transformation (happening) followed by Expansion
- NPC and MOF – Comparative Research on International Experiences of VAT System and VAT Legislation and the Legislative Proposals to China

Potential expansion of VAT system

- Key issues to be considered for the expansion of the VAT system:
 - Direction and path of VAT reform
 - Taxpayers and tax rate of VAT
 - Deduction scope of the VAT
 - Taxpayers and tax rate of VAT
 - Deduction scope of the VAT

Potential expansion of VAT system

- Challenges – future VAT should meet the following objectives:
 - Economic (e.g., VAT revenue vs VAT burden)
 - Social (e.g., impact to cost of public services)
 - Policy (e.g., export VAT refund – tools currently used for macro economic development purposes)
- International best practice vs specific needs for China

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Conclusion

Conclusion

- VAT reform – long awaited
- Welcoming move under the current financial crisis
- There are winning side while some are adversely affected (e.g., Business Tax payers and export orientated businesses)
- Uncertainties to be clarified (e.g., input VAT credit relating to mixed uses and change of use etc)
- Other indirect tax changes on their way (e.g., export VAT refund changes, adjustments to the Business Tax rules etc)
- Action: Learn about changes and understand their impact + rethink supply chain and explore indirect tax planning ideas

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Questions and Answers

Please submit all questions in English only.

http://www.pwchk.com/home/eng/webcast_cn_vat_nov2008.html

For more information, please contact:

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