

CHINA

THE PROGRESS OF VAT REFORM AND THE UPDATED VAT ENFORCEMENT REGULATIONS

On 1 January 2012 China launched a pilot program transitioning from Business

Tax (BT) to value Added Tax (VAT) for certain businesses in various regions in China. From 1 May 2016 all industries including construction, real estate, finance, and living services have been transitioned to a VAT system. As a result, the BT no longer applies in China. After the comprehensive VAT implementation, the government released a series of detailed regulations and implementation rules. The newly released VAT regulations clarify some issues regarding operational procedures including the following:

the 13% VAT rate is cancelled beginning 1 July 2017; the input VAT verification period will be extended from the previous 180 days to 360 days, and so on. The newly released regulations reduce the tax burden and have other positive influences on industries. As well, there are significant changes to the tax administration with the 2016 nation-wide rollout of the Third Phase of the Golden Tax Project (Golden Tax III). Updates to the Golden Tax III rollout have continued into 2017. The updated system will not only transform the tax authority's operating system, it will also require changes to taxpayers' tax compliance procedures.

Observations and comments

With the development of information technology and the improvement of information transparency, the Chinese tax authority is applying information technology in daily tax administration including the Golden Tax III. However, due to the lack of detailed implementation rules, a relatively immature tax system, and the fact that there is not a uniform set of operating rules related to the Golden Tax III, there are many uncertainties related to practical operations and increased tax disputes in practice. Here is a brief description of some tax issues and challenges our clients have encountered in practice:

- Tax returns cannot be filed online because tax person registration, general taxpayer registration, and so on, with local tax authorities often cannot be completed in

advance. When that's the case, a delay in filing a tax return or in making a payment can lead to imposition of late payment interest and potential penalties.

- During the VAT declaration procedure, the input VAT, which is irrelevant to a taxpayer's main business under the Golden Tax III, may trigger a tax audit by local tax authorities.
- When payments are made for cross-border charges, the system may automatically detect whether the contract has been filed/ reported to the local tax authority. If not, the system may generate notices to levy interest and possible penalties.
- Export tax refunds may not be approved because of issues related to the receipt of foreign exchange on exports. Generally, this happens as a result of the information sharing system in place among various local authorities. The tax authority's improved ability to collect and analyses data through the updated system helps the tax authorities tighten their administration of taxpayers. Tax risks that were ignored before can now automatically be detected by the tax authority, resulting in penalties and impacting taxpayers' credits on tax collection. And, practically speaking, local tax authorities have the discretion to determine the ultimate tax treatment on a case-by-case basis.

To be well prepared for the upcoming new challenges brought by the VAT reform, we recommend that taxpayers start by sorting out weaknesses in their internal control systems, improving invoice administration, and enhancing tax compliance. While taxpayers can deal with tax issues raised by tax authorities by themselves, we have found that proactive communications with tax authorities by a professional who can explain your tax position can reduce the potential tax risks. Indeed, skillful negotiation with tax authorities is essential for resolving disputes.

We will provide further news about VAT Reform in China and keep you updated. For further information in relation to any of the above topics, please do not hesitate to contact us.