



Shanghai Flash

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VAT (Value Added Tax) Pilot Program in Shanghai

The Chinese Ministry of Finance and the State Administration of Taxation jointly set out the details of the Shanghai VAT reform, which will see the business tax partially replaced by VAT starting from 1 January 2012. The pilot program is not favoured by all, and is limited to Shanghai and to certain industries only for the meanwhile.

Currently, the principal composition of China's tax system is the tax on commodities and services. The present co-existing taxing structure of VAT (a tax collected by business, but effectively borne by end-consumers) and business tax (a tax on business) was put into practice following the 1994 tax reform.

- Why Shanghai?

Shanghai's tax revenue in 2011 reached CNY 658 billion (USD 105 billion), including VAT of CNY 168 billion (USD 27 billion) and business tax of CNY 104 billion (USD 17 billion), accounting for 26% and 16% respectively.

Shanghai is an ideal choice nationwide for implementing the pilot scheme. Basically, China established a tax distribution system by setting up State Taxation and Local Taxation authorities separately, except in a few provinces. VAT is levied by the State Taxation while business tax is one of the important sources of local fiscal revenue. However, Shanghai Municipal State Taxation and Local Taxation Administration are integrated and undertake the service and administration of central tax and local tax collection together. The integrated system is favourable for the smooth transition of the VAT reform. Moreover, Shanghai's local tax revenue is capable of covering the possible financial reduction caused by the tax adjustment. Last but not least, the program matches Shanghai's ambition of developing into an advanced service sector by gradually reducing the companies' tax burden.

- Key word I: Scope of Industries

The pilot scheme is not beneficial to all the enterprises but depends on the scope of the services the companies provide. It is possible that a company providing VAT services and other services will be computed with different rates simultaneously.

The program covers the following industries: tangible movable property leasing, transportation services, logistics and auxiliary services, R&D and technology services, information technology services, cultural and creative services, certification and consulting services.

It's worth noting that financial services, real estate and construction service remain excluded from the scheme. Additionally, insurance services and post and telecommunications services are still subject to business tax at the present stage.

- Keyword II: Location - in Shanghai

Another major issue arising in the program is whether or not the business is limited only to Shanghai. The table below shows which taxes the company should refer to.

Location of service supplier	Location of service	Type of tax
In Shanghai	In Shanghai	VAT
In Shanghai	Elsewhere in China	BT, credit allowed against VAT payable
Elsewhere in China	In Shanghai	BT
Elsewhere in China	In Shanghai	BT

* from a recent KPMG report

Therefore, a company may refer to both taxes according to different locations of services it provides. The concept will involve dealings in intangible assets and leasing services.

- Applicable VAT Rates

The rules have added 2 lower applicable rates (6% and 11%) for general taxpayers besides the existing rates of 13% and 17%. The rate for small scale taxpayers remains at 3%.

Taxpayers	Industries	VAT Rates	Previous BT Rates
General VAT taxpayers (Annual sales over CNY 5 million)	Tangible movable property leasing	17%	5%
	Transportation services	11%	3%
	Logistics and auxiliary services	6%	5%
	R&D and technology services		
	Information technology services		
	Cultural and creative services		
Certification & consulting services			
Small scale VAT taxpayers (Annual sales less than CNY 5 million)	All VAT pilot services	3%	3%

In addition, **zero rate or tax-free is applied to export of service trade**. Zero rate of VAT is applied to the international transportation services, R&D and design services provided by taxpayers of the pilot program for overseas companies and institutions. VAT-free is applied to other export services of the pilot program. However, more practical details are still to be disclosed.

With the deepening implementation of the reform, Shanghai is expected to attract more regional headquarters and more companies providing advanced services, which complies with Shanghai's goal of building up four centres¹. In addition, the reform will create an eased tax environment especially for small and medium-sized enterprises by reducing double taxation. The success of the pilot scheme will ultimately be the roadmap leading to the reforms that will take place all over the country.

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¹ Shanghai is in the process of building up an international economic, financial, trade and shipping centre.