

Tax

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Tax Analysis

Comprehensive Resource Tax Reform Kicked Off in China - Water Resource Tax Piloted in Hebei Province

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A comprehensive reform of China's resource tax was launched on 1 July 2016 following the issuance of three circulars (Caishui [2016] No. 53, 54 and 55¹) by the Ministry of Finance and the State Administration of Taxation in May. As part of the reform, a water resource tax was introduced on a trial basis in Hebei province.

Originally introduced in 1984, the resource tax was levied on crude oil, natural gas, coal and other mineral resources. The resource tax regulations were further revised in 1993 and 2011. A reform piloted in Xinjiang in 2010 changed the tax base for resource tax purposes from the volume of sales to the sales price of resources (i.e. "price-based taxing method") for crude oil and natural gas. This price-based taxing method was expanded geographically and in scope in the recent years, and now applies nationwide for crude oil, natural gas, coal, rare earth, tungsten and molybdenum. However, the calculation of resource tax for other taxable resource products had still been based on the sales volume before 1 July 2016 when the comprehensive resource tax reform was launched.

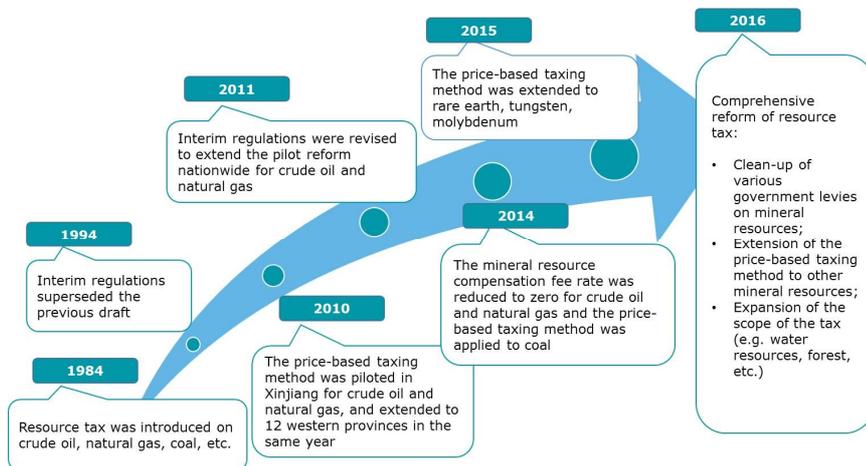
¹ Circular 55 was jointly issued with the Ministry of Water Resources.

See full text in Chinese of the circulars:

Circular 53 - http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201605/t20160510_1984605.html

Circular 54 - http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201605/t20160510_1984613.html

Circular 55 - http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201605/t20160510_1984619.html



Reform highlights

The comprehensive reform of the resource tax, launched on 1 July 2016, aims to create a fair and efficient tax regime, by eliminating duplicate charges and promoting economic development, the conservation of resources and protection of the environment.

The main features of the resource tax reform are as follows:

Clean-up of local government levies on mineral resources

The reform requires the central and local governments to carry out a review of all local levies on mineral resources, abolish any that are inconsistent with the objectives of the reform policy, and specifically to cease collecting two levies: the "mineral resource compensation fee"² and the "price adjustment fund" for all mineral resources.

Many local governments impose various levies on mineral resources in addition to the resource tax, which economically have the same or similar functions as the resource tax, resulting in a high tax burden for the mineral resource industry. The mandates to these governments under the reform should create a more equitable tax environment for the industry.

Price-based taxing method

As noted above, the calculation of resource tax for most taxable resource products previously was based on the volume of sales rather than the sale price of the resources. This mechanism has been criticized for failing to keep pace with fluctuations in the prices of resource products. The comprehensive reform rolls out the price-based taxing method to almost all taxable mineral resources. By changing the tax base from sales volume to sales price, the government intends for the resource tax to better serve as a tool for making adjustment to economic policies.

Expansion of tax scope

The reform will further expand the scope of the resource tax. Water resources (including both surface and ground water) are added to the scope of taxable resources, although taxability of water is first being trialled only in Hebei province. The government also is considering the further expansion of the scope of the resource tax to other natural resources such as forests, grasslands and mudflats. The local governments are allowed to design their own mechanisms to tax resources newly brought within the scope of the tax, although implementation must be approved by the State Council in advance.

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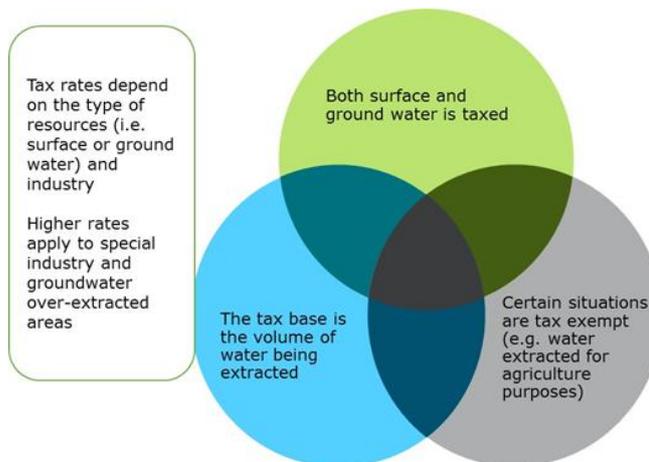
² The collection of the mineral resource compensation fee was effectively stopped by reduction of the levy rate to zero.

Water resource tax trial in Hebei province

Under the pilot program, Hebei province is levying the resource tax on the surface water and groundwater as from 1 July 2016. Entities and individuals that directly extract water from natural bodies of water (e.g. rivers or lakes) or extract groundwater are taxpayers of the tax.

Previously, entities and individuals that extracted water from these sources were subject to a water resource fee, a government levy collected by the local government department responsible for water resources.

The water resource fee no longer is imposed in Hebei, although the mechanism used to collect the fee continues to be used to collect the new water resource tax to ensure that the overall impact of the tax will be neutral. Unlike the water resource fee, however, the water resource tax is collected by the local tax authorities.



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Higher tax rates are applied in the following situations to promote the conservation of water resources:

- Extraction of groundwater in over-extracted areas;
- Extraction of water resources by special industries (including car washes, bathing, management of golf courses or ski slopes); and
- Extraction of water resources where the volume of the water being extracted exceeds a specified quota (if applicable).

The following table illustrates some water resource tax rates applicable for city areas covered by the public water supply:

(Unit: RMB yuan/cubic meters)

		General area	Over-extracted area (for groundwater)	Seriously over-extracted area (for groundwater)
Surface water	General industries*	0.5		
	Special industries	10		
Ground water	General industries*	3	4.2	6
	Special industries	40	60	80

* "General industries" excludes agriculture and public water supply businesses.

To determine whether a specific area falls within the scope of the over-extracted or seriously over-extracted area where the extraction of groundwater would be subject to a higher tax rate, taxpayers must refer to a 2014 circular (Jizhengan [2014] No. 61) issued by the Hebei government; for example, most districts of Shijiazhuang, the capital of Hebei province, are seriously over-extracted areas and most urban areas of Tangshan are either over-extracted or seriously over-extracted areas.

The introduction of higher tax rates may increase costs for water-intensive industries, such as the following:

- Coal mining and coal washing
- Ferrous metal smelting and rolling processing
- Non-ferrous metal smelting and rolling processing
- Non-metal mining
- Non-metallic mineral products manufacturing
- Textiles
- Electricity, heat production and supply
- Paper product manufacturing
- Chemical raw materials and products manufacturing
- Petroleum processing, coking and nuclear fuel processing

Affected businesses should assess the impact of the water resource tax reform on their costs and take steps to alleviate the tax burden. Such steps may include developing new technologies or processes, or finding less expensive alternative resources to lower the demand for water; and relocating certain functions to avoid the application of higher tax rates.

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